

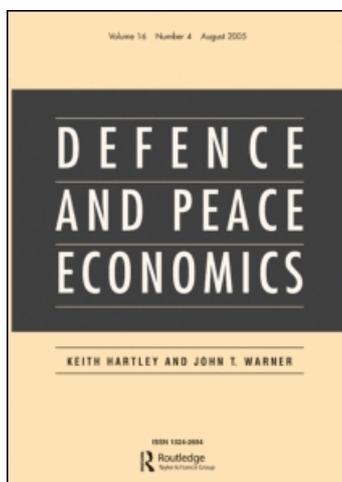
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THE EXTENT OF SINGLE SOURCING IN DEFENCE PROCUREMENT AND ITS RELEVANCE AS A CORRUPTION RISK: A FIRST LOOK

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Single-source, or non-competitive, defence procurement is a widespread phenomenon that is prevalent both in developing countries and in advanced arms exporting countries. The usual competitive bidding process – which assists in both value-for-money evaluation and in lowering corruption risk – is used much less often than expected in defence procurement. Whilst there can be good reasons for single sourcing, the opportunities and inducements for corruption are significantly escalated. Further, some countries that claim to employ single-source only in rare instances are found to have high percentages of non-competitive defence procurement. This is of particular concern as defence is perceived to be one of the more corruption-prone international business sectors, as identified in the 2002 Bribe Payers Index (Transparency International, 2002), with procurement presenting a significant source of corruption risk. The work presented here gives data on the percentage of defence single source procurement in a number of countries. Some countries were transparent and open about this data, even where it showed them in an unfavourable light. Most were not, citing sensitivity reasons or even that the data did not exist as reasons for refusal.

INTRODUCTION

Single-source procurement contracts have been identified as an issue for concern by many, for reasons dealing with transparency, democratic oversight, value for money, and corruption risk. In most countries, extant laws prohibit single-source contracts, but with exceptions for national interest or emergency regarding defence procurement; the terms in this context are often broadly defined.

Single-source procurement contracts are those contracts awarded by a government to a company without competitive process. Such contracts are also referred to as sole-source, non-competitive, or no-bid. The decision to use single-source – because most systems presume competition – is itself a corruption risk. Whilst governments once justified the use of single-source procurement with reference to protectionist instincts, the salience of such arguments has lost sway. Countries now typically claim to award single-source contracts only for reasons of expediency in emergencies, where national security interests are at stake, and rather less often as part of a national industrial strategy. Further justifications offered may include cases where the contracts are of low value, or where existing contracts contain options that allow

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them access to future contracts on a single-source basis. The research presented here will show a high percentage of no-bid contracts in many of these countries that belies such assertions.

This paper details the regional differences in uses and justifications for single-source defence procurement. Initially, we consider the development of procurement procedures in defence and address the potential relationship between reliance on single-source contracting and corruption risk. This background is followed by a presentation of quantitative data on single-source procurement and analysis by country. This section will offer perhaps the greatest contribution to existing research on the subject, as these data are sparsely available and difficult to obtain. Finally, recommendations for further action and research in the defence sector and particularly in defence procurement will be suggested.¹ Although the focus of this paper, particularly in the empirical section, is on the extent of single-source procurement in defence, the use of single-source in any sector (for example, in construction and public works, which is also vulnerable to corruption) carries the same attendant corruption risks.

BACKGROUND: DEFENCE PROCUREMENT, SINGLE-SOURCE AND CORRUPTION RISK

Efficiency, economy and the imperative for competition were rarely applied to the defence industry during the Cold War, with the UK being a notable exception in pursuing a competitive procurement policy between 1985 and 2005. The arms race taking place over the so-called Three Worlds allowed for defence industrial expansion with little concern for prudence. With the decline and end of the Cold War, the global defence industry was thrown into tumult. As national defence budgets shrank, arms-producing companies consolidated or turned to civilian operations to remain economically viable. National ministries and departments of defence were faced with a dilemma, caused by two opposing impulses in the wake of this shift. The first impulse was to prioritise value-for-money in defence procurement, to get more out of increasingly limited funds. The second was to protect national industries, deemed vital to national security interests, from possible decay due to falling demand.

The extensive use of single-source procurement in defence contracts is in many ways an outgrowth of the Cold War security environment and the immediate post-Cold War shift. National governments had not developed economic principles of competition where defence was concerned, and the initial impulse to do so at signs of relief from ever-imminent conflict was countered by protectionism and the embedded culture of secrecy. Governments attempted to shape the restructuring of the industry by encouraging mergers and civilianisation shifts, by choosing 'national champions,' and by creating or limiting competition as it was deemed beneficial or detrimental. By employing single-source contracts, governments could foster companies whose survival was seen as critical. But where the use of single-source contracts became endemic and their usage barely questioned, the snares of this type of procurement began to appear more and more frequently.

Excessive use of single-source contracts, particularly where this becomes the normal way of working for officials, makes the procurement process more vulnerable to corruption, although their presence is not in and of itself proof of corruption. The employment of competitive bidding processes increases procurement oversight, and significantly reduces the chances that a company is receiving favour for courting influence with the right people.

Of course, the use of single-source contracts is justifiable in certain contexts, such as unique technology, operational urgency, within agreed framework contracts, or in the context of a

¹ Details available at www.defenceagainstcorruption.org

specific industrial strategy. However, even when no-bid contracts seem reasonable, the potential for corruption surrounding them is higher than that around competitive processes. Courting of influence (the most egregious form of which is bribery) is likely to be involved. The defence industry is generally susceptible to corruption because of the large amounts of money concerned, the relatively low number of large contracts, and, most importantly, the fact that governments themselves are the enforcers of secrecy (Courtney *et al.*, 2002; Roberts, 2004). The actual level of corruption risk varies according to each country's practices. Whenever defence contracts are routinely secured non-competitively, these risks are heightened across the board.

The Defence Sector and its Special Position

Defence has tended to be treated as a special entity within government, often appearing exempt from the usual rules of scrutiny, oversight and procedures to ensure competition in its procurement processes, often justified with reference to national security concerns. The European Union and the United States provide some demonstration of this special status that the defence sector tends to embody in relation to avoiding standard competitive procurement processes.

Within the European Union, defence procurement contracts fall under Article 296 of the Treaty establishing the European Community, paragraph b of which states:

any Member State may take such measures as it considers necessary for the protection of the essential interests of its security which are connected with the production of or trade in arms, munitions and war material; such measures shall not adversely affect the conditions of competition in the common market regarding products which are not intended for specifically military purposes. (European Union, 2002)

Thus, in Europe, defence procurement contracts can be excused from European open market rules if member states claim that they are matters of national security.

In the United States, the Department of Defense often forms long-standing relationships with certain contractors, which can undermine the competitive process. Nine out of ten of the top defence contractors in the United States secured most of their contracts through 'less than full and open competition' between 1998 and 2003 (Department of Defense Contracting Databases, quoted in Center for Public Integrity, 2004), and numerous single-source defence contracts have been awarded for operations in Iraq (Spinner and Flaherty, *The Washington Post*, 2004). The propping up of 'national champions' can also be linked to the doling out of single-source contracts in many countries.

In both the EU and US, defence seems to be afforded this special status, which exempts it from the usual processes of due diligence and established procedures of competition. The lack of competition may be expected a priori to entail substantial corruption risks.

Single-source Procurement and Corruption Risk

The proliferation of high numbers of single-source procurement is one part of a generally opaque environment characterising the defence sector, contributing to its perception as one of the top three most corrupt international sectors (Transparency International, 2002). The US Department of Commerce estimated in 2000 that 50% of all bribes are paid for defence contracts (Daly, 2000). As an IMF report (Gupta *et al.*, 2000) on corruption and military spending explains, 'Procurement is an important channel through which corruption affects military expenditures'. Further, according to the same paper, 'Experts have estimated that bribes account for as much as 15% of the total spending on weapons acquisition'. TI(UK) has earlier published a guide to corruption risk in the specific stages of the defence procurement process (Transparency International UK, 2004).

Within defence procurement, single-source contracting becomes one of the easiest mediums for corruption to slip into the process. As Steve Shaw² has pointed out, single-source contracts are 'intuitively more prone to corruption' (Transparency International UK, 2006). In order to understand what makes this type of defence procurement more susceptible to corruption, the issue must be looked at from several angles.

Let us look first at the side of the buyer; in this case, the procurement officials making decisions on behalf of the government. In a defence procurement environment in which the single-source method is permissible, and even common, individual officials making procurement decisions have great power over which companies are going to be given the most lucrative contracts. Without the evaluative guidance and oversight of competitive process, individual preference can easily become part of these decisions. As that is the case, it is not a great leap for officials to make these decisions based on what might benefit them, and therefore to begin to look for opportunities for the process to benefit them.

From the angle of the seller, in this case the defence company, receiving lucrative contracts without facing competition is highly desirable. If it is known that single-source contracts are part of the usual defence environment and will not be scrutinised, companies can see an inducement to cut out the risk of losing a bid by influencing and/or bribing key officials to obtain a non-competitive contract. Further, there is a chance for procurement officials and companies to form ongoing corrupt relationships, in which contracts can be continually awarded in exchange for personal gain.

Competitive process necessarily includes multiple levels of oversight, in which expert bodies, usually both military and civilian, evaluate bids for quality, specificity, and value for money. With these layers of appraisal, corruption becomes much more difficult. If corruption is expected in a competitive procurement process, losing companies have the opportunity to call public and judicial attention to their concerns.

While countries may see a benefit in steering their defence markets to certain ends through non-competitive procurement, any possibility of benefits cannot be separated from the likely impact of corruption. The literature on industrial policy has provided much evidence that warns of the adverse impact that government interventions can have in general, including in relation to the corruption risk. Ades and di Tella (1997), for example, stated:

We find that a substantial part of the benefits of industrial policies is lost when the interaction with corruption is considered ... corruption is higher in countries pursuing active industrial policy ... The magnitude of the corrections estimated in this paper suggests that the consideration of corruption should not be absent from cost-benefit analyses of market intervention.

The paper describes such an instance of corruption in non-competitive defence procurement:

At the heart of the programme were two policies that gave an extraordinary amount of discretion to government procurement officials. The first was the familiar request for secrecy in military procurement. The second was active industrial policy encouraging technology transfers to local companies that would later take on the supply of military equipment to the South Korean army. As these companies progressed down their 'learning curves', they enjoyed rents that the South Korean military shared through bribes. Indeed, corruption allegations led to an investigation that ended in 1993, when Lee Chun Ku, a former defence minister, was convicted on accepting a US\$370,000 bribe for arranging a tear gas contract ... the investigations led to no less than 39 generals being sacked, reprimanded, or thrown in jail.

Problems with single-source procurement have emerged in the eyes of the public, leading to calls for reform and greater transparency. The high-profile scandal around former US Congressman Randy 'Duke' Cunningham has illuminated the sole-source and blanket

² Steve Shaw is the US Air Force Debarment and Suspension Official

contracts commonly employed by the Pentagon and the US Department of Defense. MZM, the company implicated in that bribery scandal, won a blanket contract worth up to \$225 million over five years as a sole bidder, when in fact Pentagon requirements necessitated at least three competitive bids before awarding such a contract (Babcock and Merle, *The Washington Post*, 2006). In an article entitled 'Trade Fides rejects corruption allegations', the *Czech News Agency* reported on 26 January 2006 that a Czech procurement official was recently caught in possession of funds allegedly given to him by a company that had secured large single-source contracts with the Ministry of Defence. Although these and similar cases point to a strong need for reform of single-source defence procurement practices, there are indications that the bribery scandals that reach public awareness are relatively few in terms of the corruption that actually goes on (Courtney *et al.*, 2002). For example, in the TI Bribe Payers Index, the arms industry was perceived to be the second most likely to involve bribes after Public Works/Construction.³

TI (UK) set out to research the extent of single-source procurement in defence, first by obtaining quantitative data on the subject. This data, as we quickly found, are difficult to come by. No centralised collection of such data takes place, either through supranational organisations (such as the EU and OECD) or research bodies (such as the Stockholm International Peace Research Institute and the Royal United Services Institute). The only way to obtain data on single-source procurement is to approach each country individually, usually to respective Ministries or Departments of Defence, and go through whatever channels may be available. The research is ongoing, as our only method of research was frustrated by defence bodies withholding the information. Reasons of 'sensitivity' are often cited; yet the provision of data on single-source defence procurement contracts hardly compromises national security.

TI (UK)'s research concentrated primarily on the European Union. The European Defence Agency, in order to promote competition in the defence sector, has established the Intergovernmental Regime to Encourage Competition in the European Defence Equipment Market as a transparency/competition initiative, which took effect on 1 July 2006.⁴ Under the voluntary agreement, participating member states should begin providing their data on single-source defence procurement to the Agency as of this date. Yet some member states still refuse to release the data to TI (UK), while others insist that they have no such data. It may be concluded that if the reasons for whatever number of single-source contracts exist in these states were entirely defensible, there should be no reason not to open this data to public scrutiny.

What may be more likely than a lack of extant data is that, as the EU has recognised non-competitive procurement as a serious problem for contemporary defence procurement, member states are shying away from acknowledging the amount of single-source procurement in their borders, and the explanations behind it.

It is notable that the mere attainability of data for these countries shows, coming out of such an opaque environment, a considerable effort at transparency. To share this data with TI, with the public, or with another research institute, demonstrates a laudable willingness to open up defence procurement processes. These countries, such as the Czech Republic, are to be commended for their transparency, regardless of what the data may tell us about their current procurement practices.

A second, more positive, area of procurement is that of the various NATO agencies. NATO has some very particular rules for its own procurement, most notably that its member countries all get a chance to put their own companies forward; the NATO Management and Supply Agency (NAMSA), for example, notes as part of its General Rules and Provisions on its

³The dataset with explanatory notes is publicly available at http://www.transparency.org/policy_research/surveys_indices/bpi

⁴For more details see <http://www.eda.europa.eu/genericitem.aspx?id=153>

website⁵ that, ‘International competitive bidding by firms located in NAMSA countries is the norm. (Only in special cases can a sole source be used or competition extended beyond NAMSA countries)’. The circumstances where single-source procurement can be used are detailed in the NAMSA Procurement Regulations as follows: for reasons of urgency; if an existing contract contains a valid option beneficial to NAMSA customers; if the contract to be offered for single-source are of low-value below a specified figure; or if security requirements limit distribution of data (NAMSA, 2005).

On account of the intense interest between countries as to who has the companies with the best resources to compete, almost all NATO contracts are competitive. Although competitive procurement data are not officially publicised, the single source percentages are believed to be low. In a personal communication in April 2006, one of the key NATO agencies has communicated 13% to us, a significant proportion of that being on account of purchases of Microsoft software.

DATA ON SINGLE-SOURCE DEFENCE PROCUREMENT

Having identified the potential for corruption risk in defence establishments owing to single-source procurement, we now focus on the extent to which single-source contracting is employed in defence contracting.

Figure 1 gives a comparison of non-competitive defence procurement across the countries for which TI (UK) was able to obtain data. Because of incompatible definitions and some lack of detail, the data do not compare single-source procurement specifically, but non-competitive procurement more broadly, because in some cases it was only possible to obtain data in this format without further categorization. Most ‘non-competitive’ procurement is, however, single-source. A detailed description of the methods used to obtain these data and of the sources in their given form can be found in Annex 1.

Figure 1 differentiates between percentages by value and number of non-competitive procurements out of the total defence contracts, and where possible both figures are displayed. By value, the countries here range from 3% to 84% single-source defence procurement; by number, from 20% to 65%. We attempted to obtain single-source defence procurement data from many more countries than are seen here, and were unable to do so. The countries that would not provide this data and a discussion of possible reasons for withholding such information is presented in a later section. The current section will analyse the data as we have it, for nine countries.

A Note on Framework Contracts

Some of the problems we had with comparing and analysing data quite probably deal with the grey area of framework, or blanket, contracts, which are increasingly employed in both the US and European defence arenas. Framework contracts are standing agreements used as a basis for goods and services purchases as need arises. Defenders suggest that these agreements can save time and money by eliminating numerous bidding processes. But other experts have concerns. In interviews by the authors with procurement expert Christopher Yukins,⁶ it was pointed out that in the US, frameworks represent ‘a huge and growing wedge of contract dollars’ that is non-transparent, as well as unaccountable regarding competition. While the debate on the utility of frameworks continues on both sides of the Atlantic, the fact remains

⁵ http://www.namsa.nato.int/suppliers/gen-prov_e.htm

⁶ Professor Christopher Yukins is Associate Professor and Co-Director of government Procurement Law Program, George Washington University. Professor Yukins’s papers are publicly available at http://papers.ssrn.com/sol3/cf_dev/AbsByAuth.cfm?per_id=333989

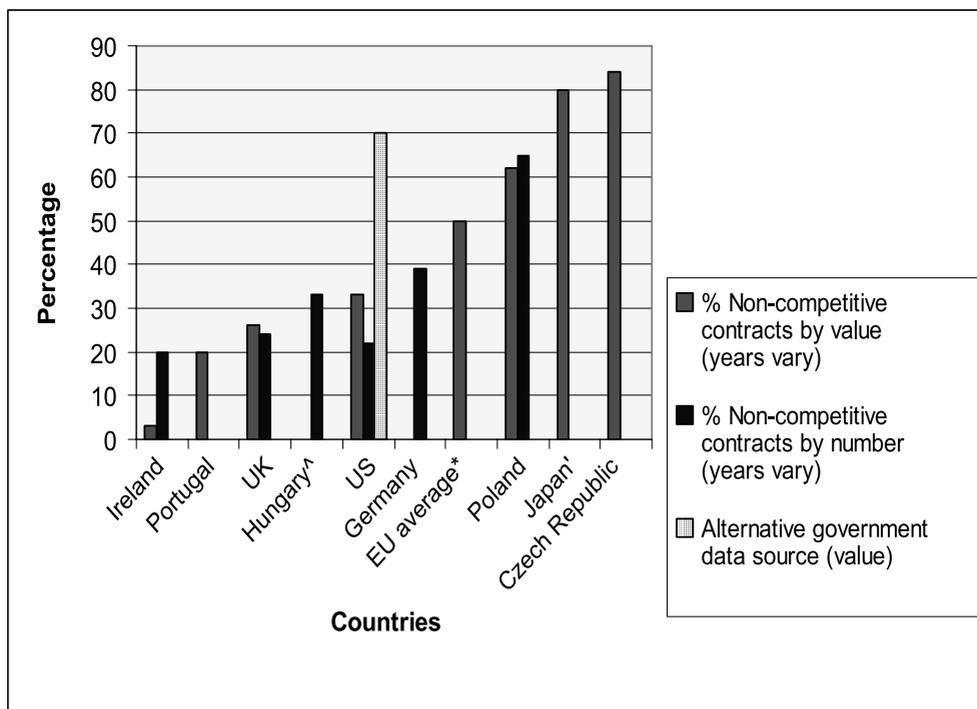


FIGURE 1 Non-competitive defence procurement contracts as a percentage of total defence procurement (Transparency International (UK) May 2006)

Notes: * EU data is an estimate, taken from Watson, Rory, 'Brussels moves to open up defence contracts'. *The Times*, 7 December 2005. Copyright 2005 Times Newspapers limited.

[^] Hungary data estimated from Answers of the Republic of Hungary to the questions formulated in the 'Green Book on Defence Procurement' of the European Commission.

Japan data from Singh, Ravinder Pal (ed.) (1998) *Arms Procurement Decision Making Volume I: China, India, Israel, Japan, South Korea, and Thailand*. SIPRI. Oxford University Press.

All other data obtained from official government sources of respective countries.

that categorising contracts placed under these conditions as 'competitive' or 'non-competitive' is extremely difficult. Often prices are not fixed when frameworks are drawn up, leaving the agreements open to corruption risk. Certainly frameworks, where employed, should be made as transparent as possible. Professor Yukins suggests that for products that compete on price alone, governments 'could run fully public reverse auctions among their framework contracts holders'. While analysis of framework methodologies in the countries that use them would contribute to a deeper understanding of competition in those countries, such analysis is beyond the scope of the current paper. TI (UK) would welcome further study of framework agreements in the defence sector, both in the context of competition and for the separate corruption risk issues they present.

Ireland and Portugal

Ireland sets the bar for competitive defence procurement in Europe. With just 3% of the value of their total defence procurement single-source (or 20% by number), Ireland has the lowest non-competitive procurement of all the countries for which we have data. With its impressive economic growth over the last decade, Ireland has also begun expanding and modernising its defence forces, including increased procurement of defence equipment. This expansion has been done prudently and cost-effectively.

Portugal has comparatively low non-competitive defence procurement in the context of the EU. Like Ireland, Portugal does not have a large domestic defence industry. Portugal's non-competitive defence procurement is at a yearly average of 22% of total value.

We may speculate at least two reasons as to the relatively low level of single-source procurement in these countries. First, both have relatively small defence budgets; this may provide an imperative to use value-for-money procurement procedures. Second, neither has a substantial home defence industry; thus there is no temptation to follow interventionist defence industrial policies. In addition to the obvious benefits of prudent procurement, these countries would also not be subject to the elevated inducement to corruption that countries with high non-competitive defence procurement experience.

The United Kingdom

The UK has generally been considered the leader in opening up defence procurement in Europe, since the 1988 'Action Plan on a stepwise development of a European Armaments Market' (see Walker and Gummet, 1989), an early forerunner of actions currently being undertaken by the EU and the EDA. Interestingly, the political impetus for this drive for market competition in the 1980s was related to shrinking defence budgets, causing the UK governments to become keenly interested in value-for-money in defence contracts. Under this period of competitive defence procurement, there was a relatively low level of single-source procurement.

The UK Ministry of Defence publishes its data on single-source procurement annually. For 2004/2005, for example, the MoD states that by value, over 70% of contracts were placed by competition. As broken down graphically, 65% were placed by pure competition, while 8% were 'priced with reference to market forces'. The MoD combines these figures for its 'over 70%' declaration (Ministry of Defence, 2005a). Our charted UK figure uses three years of published data to give 27% of contracts by value and 25% of contracts by number made through non-competitive procedures. The UK has recently signed on to the EDA Code of Conduct for competition.

This record of competition, however, may be shortly disturbed. According to the MoD's new Defence Industrial Strategy (DIS) under former procurement minister Lord Drayson, the MoD will be forming closer relationships with British defence companies in order to advance a 'mutually beneficial' agenda (Ministry of Defence, 2005b). Although it remains to be seen exactly how this will be fleshed out, the implication is that Britain will now be concentrating less on competition, and perhaps more on an American-style approach of long-standing 'blanket' agreements with favoured companies. Dr Steven Schofield of the British American Security Information Council (BASIC) points out in his paper on the Defence Industrial Strategy: 'What is ... interesting about the DIS is the greater clarification given to the consistent but less transparent policy of protecting those industrial and technological capabilities deemed essential for national security, despite the rhetoric that still surrounds competitive tendering and market principles' (Schofield, 2006).

The Strategy suggests benchmarking on specific objectives to monitor the efficacy of new procurement procedures. While benchmarking in this context seems unlikely to be a complete solution, especially in the area of corruption, the MoD is attempting to address through the DIS legitimate concerns over retaining key market capability in the UK.

Hungary

While Hungary did not supply its data on non-competitive defence procurement, and in fact stated that no such data exist, we have been able to locate a yearly average percentage on

non-competitive defence procurement in Hungary, from a submission made by Hungary to an EU consultation entitled 'Answers of the Republic of Hungary to the questions formulated in the "Green Book on Defence Procurement" of the European Commission'. By number, about a third of Hungary's defence procurement, according to this source, is non-competitive.

Hungary's post-Communist period saw rapid decentralisation and privatisation in the defence industry. In the 1990s, laws on publicising defence procurement tenders were put in place. However, as with most other countries, exceptions for 'national security' are allowed. Behr and Siwecki (2004) point out that while the prescribed method of military procurement involves bid analysis with multi-level oversight, '[E]xceptions can be made to these standard [procurement] procedures for reasons of national security and for the promotion of domestic production and employment. In practice, most of the bigger procurement decisions have been made at the level of the office of the Prime Minister' (Behr and Siwecki, 2004). These exemptions from oversight may mean additional corruption risk around non-competed contracts.

Poland

An excellent 2004 report from the Institute for Security Studies delves into Poland's defence sector. Since 1999, Poland has been pursuing an active defence industrial policy in an attempt to foster the manufacture of priority equipment, as well as export and offset potential. The policy is designed to give the Polish government maximum control over industry, to the extent that despite the ever-growing distance from the Communist years, 'as a consequence of the strategy of structural transformation, the majority of Polish defence industry will ... remain state-owned' (Behr and Siwecki, 2004). Two main consolidated arms production groups were formed as a result of the industrial strategy: Bumar, for land products, and ARP for aeronautics and electronics (Behr and Siwecki, 2004). The defence complex is dictated by Ministry of Defence priorities, and this is reflected in the country's large percentage of single-source procurement. More than half of Poland's defence procurement was single-source in 2005, at about 62% by value and 65% by number.

Corruption issues in Poland in recent years have been linked to the nature of the procurement system in several reviews. A US State Department report notes:

In actual practice, many government procurements are carried out in a non-transparent manner that has produced highly publicized accusations of corruption. (Bureau of Economic and Business Affairs, 2002: 7)

Further, the Open Society Institute's 2002 report on Corruption and Anti-corruption explains:

Polish public procurement legislation is largely compatible with EC requirements, and changes to the law that came into effect in 1997 have done much to end the most flagrant corrupt practices. However, the Public Procurement Office appears unable to check enough procurements, and various sources indicate that corruption remains widespread. The biggest scandal of the present Government resulted from corruption in a public tender at the Ministry of Defence. (Open Society Institute, 2002: 398)

The Polish Ministry of National Defence is currently implementing anti-corruption programmes, having appointed a former chair of TI Poland and expert on procurement procedures, Maciej Wnuk to a senior position for this purpose. A review (Wnuk and Pyman, 2006) of the Polish MND's reforms is publicly available at the TI (UK) defence sector website.

The United States

The US publishes its data on competitiveness of defence procurement contracts annually. According to the Federal Procurement Data System, a yearly average of 33% by value and

about 22% by number of all US defence procurement contracts are non-competitive.⁷ As mentioned above, nine of the ten top US defence contractors secure the majority of their contracts without full and open competition (Department of Defense Contracting Databases, quoted in Center for Public Integrity, 2004).

It is worth noting that the percentage *value* of non-competitive procurements in the US is higher than the percentage by raw number. In fact, a 2004 Inspector General report cited that for Iraqi funds under US administration, 'though only about 4 percent of the contracts in fiscal 2003 were awarded without any competition, the sole source contracts were worth more than \$3.2 billion, nearly one-third of the total.'⁸ This indicates the large scale of non-competitive procurements; the potential for bribery in such cases is arguably immense. Reliance on sole-source increases the risk that bribery, even involving a single person, can lead to massive corruption costs.

Also of note is that while the Federal Procurement Data System (which is the most reliable US procurement data source) tells one story, another report detailing defence procurement for fiscal year 2003 tells quite another. The report in question is the 'Report Required by Section 812 of the National Defense Authorization Act for Fiscal Year 2004'.⁹ The primary purpose of the report is to explain foreign sources of supply in US defence. However, it also includes a 'Summary of all DoD contracts for Defense Items and Components Awarded (Fiscal Year 2003)' with numbers and percentages of competitive and non-competitive defence contracts. According to this source, for fiscal year 2003, 70% of all defence contracts were non-competitive by value, and 42% by number. While TI (UK) is unable to account for this discrepancy, it should be stressed that this is a very large dataset, which contains highly subjective figures; the Federal Procurement Data System is likely to be more reliable.

Japan

Among OECD countries, Japan is remarkable for its minimal spending on defence projects, both in real numbers and as a percentage of GDP. Article 9 of the Japanese Constitution rejects the use of military force to settle international disputes, and to this end severely limited defence spending as well as defence exports.

With Japan's defence industry left with such limited opportunity, the few companies who remained were covered by strong protectionist policies. This led to a procurement system heavily reliant on single-source contracting, and the emergence of what critics consider to be a highly corrupt procurement system (Yamamoto, 2004). According to the *Review of the Central Procurement for 2002* by the Central Office of the Japan Defence Association (quoted in Yamamoto, 2004), 80% of Japan's defence procurement by value was non-competitive at that time.

The Czech Republic

Transparency International (CZ) has done extensive research on defence procurement in the Czech Republic. They state in their report 'Public tenders in the military sector in the Czech Republic':

How these tenders are awarded is however a substantially more important issue than the absolute value of military contracts ... The results are not very satisfactory from the aspect of enlargement of the international public procurement market. Only 4% of resources for the purchase of public goods and services in the military

⁷ Federal Procurement Data System. <https://www.fpds.gov/common/html/login.html>

⁸ 'Iraq Rebuilding Plan Reviewed' Washington Post, 31 March 2004.

⁹ 'Report Required by Section 812 of the National Defense Authorization Act for Fiscal year 2004' (Public Law 108-136), Foreign Sources of Supply: Assessment of the United States.

sector were allocated in open tenders. On the contrary, as much as 90% of resources were allocated by direct awarding to one applicant. (Transparency International CZ, n.d.)

This source provides the figure of about 85% of contracts by value being made through non-competitive procedures.

The defence industries in the countries of Eastern Europe suffered tremendous shocks at the loss of Soviet demand. In an effort to preserve their national industries, some of these countries became highly protective of their domestic companies. While the Czech Republic has won praise for its economic reforms and swift EU accession, its defence procurement still lies outside of general Czech and EU procurement rules.

In 2005, the issuance of the EU Green Paper on Defence Procurement brought about the opportunity for the Czech Republic to express its views to the rest of the Union. Czech concerns are highlighted:

One of the main reasons for fragmentation of defence equipment market, in the Czech Republic's opinion, is the fact that individual EU states make use of their own funds for defence development. Such investments are closely scrutinized by taxpayers of each country and it is critical that each state make sure at least part of the investments returns in the form of national suppliers' share in contracts at hand. (Permanent Representation of the Czech Republic to the EU, 2005: 1)

The Green Paper response suggests that the current EU efforts might make newly acceded countries more willing to open their defence markets. This is an important consideration for European policy-making.

In April 2006, military spokesman Andrej Cirtek announced that all Czech defence procurements over 1 million will be opened to the European defence market. Czech firms will no longer be handed government contracts; but they will have the opportunity to compete in Europe. Previous rules had compelled all Czech companies wishing to sell defence products to other EU countries to apply for a government licence, a two-month process. This stipulation made it very difficult for Czech firms to compete, and it has now been dropped, coinciding with the new openness.

Germany

By its own declaration, Germany does not employ any defence industrial policy (see Mawdesley, 2002). The country claims as one of its defence procurement principles the imperative of competition; this comes from the country's historical insistence that defence activities be broadly economically beneficial (Mawdesley, 2002). Yet the data provided by the German MoD, for years 2002, 2003, and 2004, exhibit an average of almost 40% single-source procurement in contracts by number. This displays a substantial discrepancy between policy and practice.

Discussion

The above data, while limited both in terms of being derived by separate methodology for each country and by the relatively small size of the sample, does allow us to make some tentative conclusions which should inspire further study in this area.

First, the data from Ireland and Portugal suggest that the absence of a domestic defence industry may make political leaders engaged in procurement processes less susceptible to demands for single-source contracting as a means of nurturing domestic industries. At the other extremes are Japan, the Czech Republic, and Poland, all of which pursued industrial strategies in defence designed to promote their domestic industries. Each of these countries had high levels of single-source procurement.

The USA data has been more difficult to interpret; although maintaining a strong defence industry, using the data from the Federal Procurement Data System suggests that this has not

resulted in a level of single-source contracting in defence comparable to that of, say, Japan. However, if we used the alternative data set, the experience would be consistent. An alternative interpretation, however, is that if the true underlying level of single-source procurement in the US is closer to 40% than 70%, this may be related to the existence of export markets; the presence of a strong external market for defence products may mean there is less demand on the part of industry for single-source procurement in the home country. Indeed, the experience from the Czech Republic would also support this hypothesis, as we noted above that part of the motivation for industrial policy in defence was related to the collapse in demand from the Soviet Union for defence products, leading to increased action from the government in the defence industry.

Second, tight political and fiscal restraints on governments, and the imposition of these onto defence ministries, may create an imperative for the use of more competitive procedures in defence contracting. If competitive procedures allow for more efficient use of resources than non-competitive processes, the imposition of tight budgetary constraints may make defence ministries more likely to pursue procedures based on value-for-money considerations and not considerations of supporting domestic industry. This hypothesis finds support from the UK experience, where a competitive procurement strategy was pursued from the late 1980s until the mid-2000s, owing to political and economic conditions that forced tighter budgetary requirements onto defence establishments. This was despite the presence in the UK of a strong domestic defence industry. Further, the experiences of Ireland and Portugal, which similarly imposed budget restraints on their defence ministries, provide support for this hypothesis; their defence ministries able to maintain low levels of single-source contracting, possibly partly related to the limited availability of resources.

In summary, the following processes may have influenced the level of competitive procurement procedures: (1) the presence of an activist industrial policy in defence; (2) the presence of an external market for defence products in those countries with domestic defence industries; and (3) political and economic restraints on resources available to defence ministries.

Further study based on multivariate regression analysis may be able to provide evidence as to which of these effects dominated. Such an exercise is beyond the scope of this paper, and would require a vastly expanded sample of countries. The biggest challenge in such an exercise would be obtaining the data and transforming it into a format to allow comparison, as our subsequent note on data limitations explains.

Another avenue of further study worth pursuing would be to examine the proposed link between corruption and the extent of single-source procurement. In the first half of this paper, we outlined the mechanisms by which these may reasonably be expected to be linked; our empirical section, however, focused on the extent of single-source procurement in defence, rather than on the corruption risk, which is theoretically inherent in non-competitive contracting. Bridging this empirically would be a valuable exercise, but one that was beyond our scope.

LACK OF DATA FOR SOME MAJOR ARMS BUYERS

Many of the countries that TI (UK) approached for data on single-source defence procurement never provided us with the data. Of these, most simply never got back to us, despite repeated emails, faxes, and phone calls to numerous contact points.

A few countries responded by saying that no such data were collected within their jurisdictions. Belgium and Hungary both stated that non-competitive defence procurement data did not exist for their countries. These countries did supply us with descriptions of their procurement processes and their allowances for single-source contracts.

It is even more peculiar in the context of EDA efforts at procurement reform. The EDA will not be publishing the data it started collecting on 1 July 2006. In light of the fact that the EU

states (barring Denmark) have signed on to the reforms at least in principle, they should have to start recording and reporting this data soon, if they have not up to this point. It can be hoped that the new standards will improve the situation, and that the collection of these data will lead to strengthened transparency for these countries. The EDA will not be able to release these data publicly, but these countries will be applauded if they choose to publish their data in demonstrations of transparency.

One of the problems with evaluating and comparing the data we were able to obtain was a lack of consistency across, and sometimes within, countries. Broadly defined categories, as used in the UK's publication, also make full understanding of procurement practices difficult. The publication of fully consistent and transparent data would be a great help to further research on this topic, leading to more comprehensive and conclusive analysis.

CONCLUSIONS

In this work we have found data to support the concern that an unexpectedly high percentage of defence work is awarded through single-sourced contracts in many countries and not through competitive procurement. The fact that it is practicable to have a high competitive percentage is made clear from some of the country returns. We also note that organisations such as NATO are able to have a high competitive procurement percentage despite it being at the more sensitive end of the security spectrum. We have noted other countries, often developing countries such as Colombia, who have made clear and effective efforts to insist on competitive bidding in the bulk of procurements, even though the national procurement law allows for exemption.

It is striking, and commendable, that some countries are transparent with their information, even when it shows them in an unflattering light, such as in the case of the Czech Republic, Poland and Japan. Others, such as France, Italy and Hungary, declined to reveal data, although we find it impossible to believe that the data are either restricted or in any way classified.

Currently, most countries have provisos regarding non-competitive defence procurement, but the exceptions are vague and non-transparent, and therefore easily circumvented. The process by which single-source is chosen as the method of procurement should be made transparent, and the percentage that is non-competitive should be published in detail annually.

When the single-source method of procurement is employed, clearly defined measures should be introduced to reduce the risk of corruption. These include multiple levels of oversight and approval, personal asset declarations, rotation of staff in key positions, rigorous internal and external audits focused on influence, benchmarking and open-book pricing.

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ANNEXE 1: CALCULATIONS OF SINGLE SOURCE AND COMPETITIVE CONTRACT INFORMATION: SOURCE DATA AND ASSUMPTIONS MADE

Introduction

For ease of checking and validating the data that we present in the main paper, this Annexe contains the raw data that were available to us. In several cases there are ambiguities of interpretation, particularly on the meaning and definitions of single source contracts, competitive tenders and framework contracts. We have, in most cases, not been able to resolve these uncertainties. Wherever possible, an average of several years has been used to dispel possible outliers. We welcome comments and clarifications where authorities and others have more extensive data.

Ireland

In an email from 15 March, the Department of Defence Press Officer for Ireland provided us with table I:

TABLE I

	<i>No of sole-source contracts</i>	<i>Value (incl. VAT @ 21%) Euro Mln</i>	<i>Countries of sole-source (number of orders placed)</i>	<i>No of orders placed</i>
2003	10	3	Sweden (1), Finland (1), Switzerland (1), Germany (1), United Kingdom (3), Denmark (1), Ireland (2)	84
2004	13	3	Sweden (2), United Kingdom (6), Ireland (5)	62
2005	25	10.3	Sweden (1), Switzerland (1), Germany (2), United Kingdom (8), Austria (1), USA (2), Belgium (2), Canada (1), Ireland (7)	94

In order to get the percentage in value of single-source contracts out of total defence procurement contracts, it was necessary for us to find the total value of defence procurement for the years listed. Defence expenditure information for the Republic of Ireland can be found for the years 2003 and 2004 in the Defence Forces' Annual Report 2004, at www.military.ie/images/ann_report_04/AnnualReport04_En.pdf. The figures are found on page 49 of this report, for both 2003 and 2004, in the respective Outturn columns. In order to find total procurement expenditure we added the following categories: G. Defensive Equipment + H. Aircraft + I. Military transport + J. Ships and naval equipment + K. Barrack expenses and engineering equipment + L. Buildings + M. Ordnance, Clothing & Catering, + N. Communications & Info Technology + O. Military training (courses and equipment) + P. Travel & Freight.

Totalling the above, we found the total defence procurement for 2003 at 191,919,000. For 2004, the total was 197,274,000. The 2005 report had not yet been completed, so we were forced to rely on planned defence expenditure, which, looking back at Ireland's recent statistics, should not differ greatly from actual expenditure.

The 2005 planned defence expenditure for the Republic of Ireland can be found on the Department of Defence website at <http://www.defence.ie/website.nsf/Document+ID/F38D3F9BF073362B802570BA00447942?editDocument>. We summed the following categories to obtain total defence procurement for 2005: Defensive equipment, Air Corps – equipment, fuel maintenance, etc., Naval Service – equipment, fuel maintenance, etc, Barrack expenses, repairs and maintenance of land, Buildings – capital, Military transport – new vehicles, fuel, repairs and maintenance.

The total defence procurement, obtained by adding the above, is €149,000,000. Taking these totals, we could then divide the single-source numbers provided by the DoD to obtain the percentage of single-source defence procurement out of the total defence procurement:

2003 – €3,000,000/€191,919,000;

2004 – €3,000,000/€197,274,000

2005 – €10,300,000/€149,000,000

Total – €16,300,000/€538,193,000 = 0.03 = 3% non-competitive by value. For the percentage of the total number of contracts, we used the numbers provided in the above table:

2003 – 10/84

2004 – 13/62

2005 – 25/94

Total – 48/240 = 0.2 = 20% non-competitive by number.

Portugal

In an email from 9 February 2006, the Instituto dos Mercados de Obras Públicas e Particulares e do Imobiliário, Portugal sent as a response to our query a chart detailing all defence contracts for the years 2002–2005 inclusive. Defence contracts are separated into three categories: concursos publicos (publicly tendered contracts), concursos limitados (limited tendered contracts) and concursos por negociação/ajustes directos (contracts by negotiation or direct adjustment). The third category, then, is non-competitive. Here is a distillation of the full chart, without the individual listing of each contract, with the percentage of single-source contracts within total contracts for each year highlighted in bold.

Portuguese Ministry of Defence contracts

COMPETITIVE / NON-COMPETITIVE	Value (Euro)	Percentage	Year
CONCURSOS PÚBLICOS	3,308,028	62.7%	2005
CONCURSOS LIMITADOS	1,011,811	19.2%	2005
CONCURSOS POR NEGOCIAÇÃO / AJUSTES DIRECTOS	955,321	18.1%	2005
CONCURSOS PÚBLICOS	13,696,431	59.7%	2004
CONCURSOS LIMITADOS	4,300,210	18.7%	2004
CONCURSOS POR NEGOCIAÇÃO / AJUSTES DIRECTOS	4,952,640	21.6%	2004
CONCURSOS PÚBLICOS	16,362,492	68.4%	2003
CONCURSOS LIMITADOS	5,707,895	23.9%	2003
CONCURSOS POR NEGOCIAÇÃO / AJUSTES DIRECTOS	1,846,605	7.7%	2003
CONCURSOS PÚBLICOS	3,802,399	29.6%	2002
CONCURSOS LIMITADOS	3,900,342	30.4%	2002
CONCURSOS POR NEGOCIAÇÃO / AJUSTES DIRECTOS	5,128,408	40%	2002
CONCURSOS PÚBLICOS	37,169,289	57.2%	2002–2005
CONCURSOS LIMITADOS	14,920,258	23.0%	2002–2005
CONCURSOS POR NEGOCIAÇÃO / AJUSTES DIRECTOS	12,882,974	19.8%	2002–2005

The chart is done by value, so in order to get the percentage of non-competitive contracts out of the total, we added up the three values for each year, then added just the concursos por negociação/ajustes directos, and put the latter over the former.

2002 – €5,128,408/ €12,831,149

2003 – €1,846,605/ €23,916,992

2004 – €4,952,640/€22,949,281

2005 – €955,321/ €5,275,160

Total – €12,882,974/€64,972,582 = 0.198 = 19.8% non-competitive by value.

The United Kingdom

The source data for the United Kingdom can be found at the UK National Statistics website:

For 2002, <http://www.dasa.mod.uk/natstats/ukds/2002/chap1frame.html>

For 2004, <http://www.dasa.mod.uk/natstats/ukds/2004/c1/sec4tab114.html>

For 2005, <http://www.dasa.mod.uk/natstats/ukds/2005/c1/table114.html>

We used these three years for our report. The published statistics include percentages both by value and by number. In each of the tables for the above years, the first two contract categories are competitive, ‘Contracts priced by competitive’ and ‘Contracts priced by reference to market forces.’ The remaining categories, ‘Contracts priced by estimate at outset or as soon as possible thereafter’, ‘Contracts priced on actual costs with incentives to minimise costs’, and ‘Contracts priced on cost plus a % fee’ are non-competitive. In order to get the total percentage of non-competitive contracts, we simply added the given percentages for each non-competitive category. By value, for 2001/2002, 31% of contracts were non-competitive; for 2003/2004, 21% were non-competitive; and for 2004/2005, 27% were non-competitive, for an average of 26% non-competitive by value for the three years. By number, for 2001/2002, 17% were non-competitive; for 2003/2004, 22% were non-competitive; and for 2004/2005, 32% were non-competitive, for an average of 24% non-competitive by number for the three years.

A caveat is in order. The second category of contracts is described as ‘Contracts priced otherwise by reference to market forces’. It is not clear to us if this is the same as ‘competitive tender’, as it could simply mean that reference had been made to comparable market prices, without any competitive tendering. Given that wording, it is thus possible that some of the contracts in this category might not include real competition, but instead are priced using some sort of government-created simulation of competitive pricing. However, since the MoD includes this category as competitive themselves we too have incorporated this category as competitive.

The United States

The source data for the United States is of good quality and can be found at http://www.acq.osd.mil/ip/docs/812%20_report_fy04_addendum.pdf. The report includes a ‘Summary of all DoD Contracts for Defense Items and Components Awarded (Fiscal Year 2003)’. The chart details competitive contracts and non-competitive contracts out of total number of contracts by both value and number. For fiscal year 2003: Number of non-competitive contracts, 31,132; Total number of contracts, 74,266; Value of non-competitive contracts, \$46,347,775; Total value of contracts, \$66,155,321. From this we calculate:

Percentage of non-competitive contracts by number: $31,132/74,266 = 0.419 = 42\%$

Percentage of non-competitive contracts by value: $\$46,347,775/\$66,155,321 = 0.700 = 70\%$

Czech Republic

The source data for the Czech Republic was obtained through Transparency International Czech Republic. Again, the data are comprehensive and readily available. The source data

chart is available on the TI (CZ) website at www.transparency.cz/index.php?lan=uk&id=2770. As the website states, the figures were originally published on the Czech Army website, www.army.cz, and TI (CZ) has done the calculations. Over the three years listed, 2002–2004 inclusive, 90% of defence procurement contracts were single-source, directly awarded to one applicant. The yearly average is 84% single-source.

Japan

The source data for Japan is from a RUSI article entitled ‘Japan: Government and the Defence Industry’ by Gen Yamamoto at www.rusi.org/downloads/pub_rds/6yamamoto.pdf. The article states that ‘the share of discretionary contracts (non-competitive awards) was still over 80 per cent of all contracts in 2002.’ The source cited for this number is www.cco.jda.go.jp/pdf/index2.pdf, which is a document in the Japanese language. Attempts to contact the Japanese Defence Agency to obtain any sort of information from them in English received no response. We have recorded the figure as 80% on our chart, as we do not know the exact number from the Yamamoto article and we would like to err in favour of the country. In addition, Gen Yamamoto was not available to speak to, in order to find out whether his figure is by number or by value. However, Ravinder Pal Singh’s volume entitled *Arms Procurement Decision Making, Volume 1: China, India, Israel, Japan, South Korea, and Thailand* states that, in 1995, Japan’s non-competitive defence procurement stood at 86% by value. We can infer, then, that Yamamoto’s figure is also by value.

Hungary

Hungary’s Ministry of Defence informed the authors that they did not have data on the use of single-source procurement. However, a submission to a European Union consultation on defence procurement from 2005 provided the figure of 30–35% used by the authors in this paper. This figure should be treated with extreme caution.

Poland and Germany

The data on Germany’s and Poland’s use of single-source procurement was based on data sources provided by those governments to the authors.