

# **Corruption Risks of Offsets and Preventative Mechanisms**

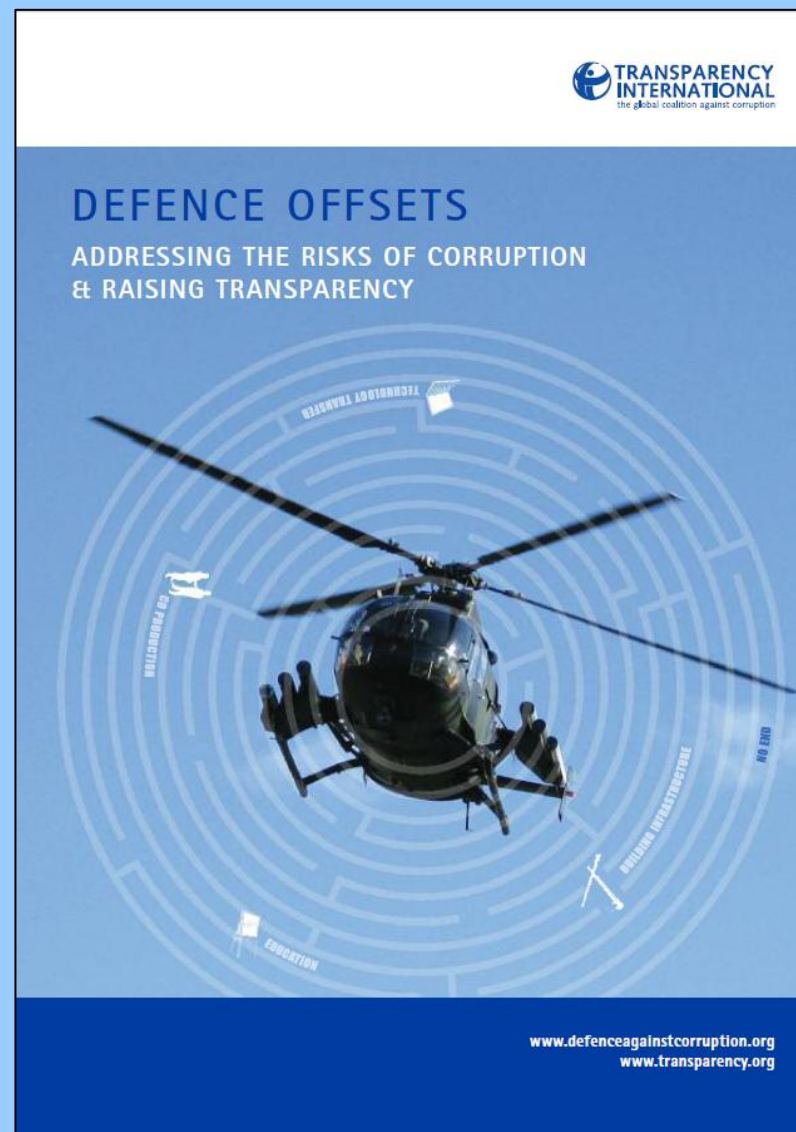
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**Julia Muravska**

Defence and Security Counter-Corruption Programme  
Transparency International

# What Are Offsets?

- When buying military equipment from foreign companies, governments oblige them to reinvest a % of the contract into the importing country
- Example: government buys fighter aircraft, requests selling company to build factory that makes missiles for the fighter aircraft = direct.
- Example: government buys fighter aircraft, requests selling company to invest in building a local school= indirect



# Why Do Offsets Matter?

130 countries using offsets; almost all countries require offsets when purchasing defence equipment

*Maj. Gen. Suman. ; TI*

Offsets may range up to 300% of main contract value and often approach or exceed 100%

*Nick Whitney, ECFR*

Global value of outstanding offset contracts estimated as \$75 - \$100 bn

*Sylvia Pfeiffer, FT*

Defence among the most corruption-prone sectors; Defence sector: 50% of all bribery allegations over 1994-1999

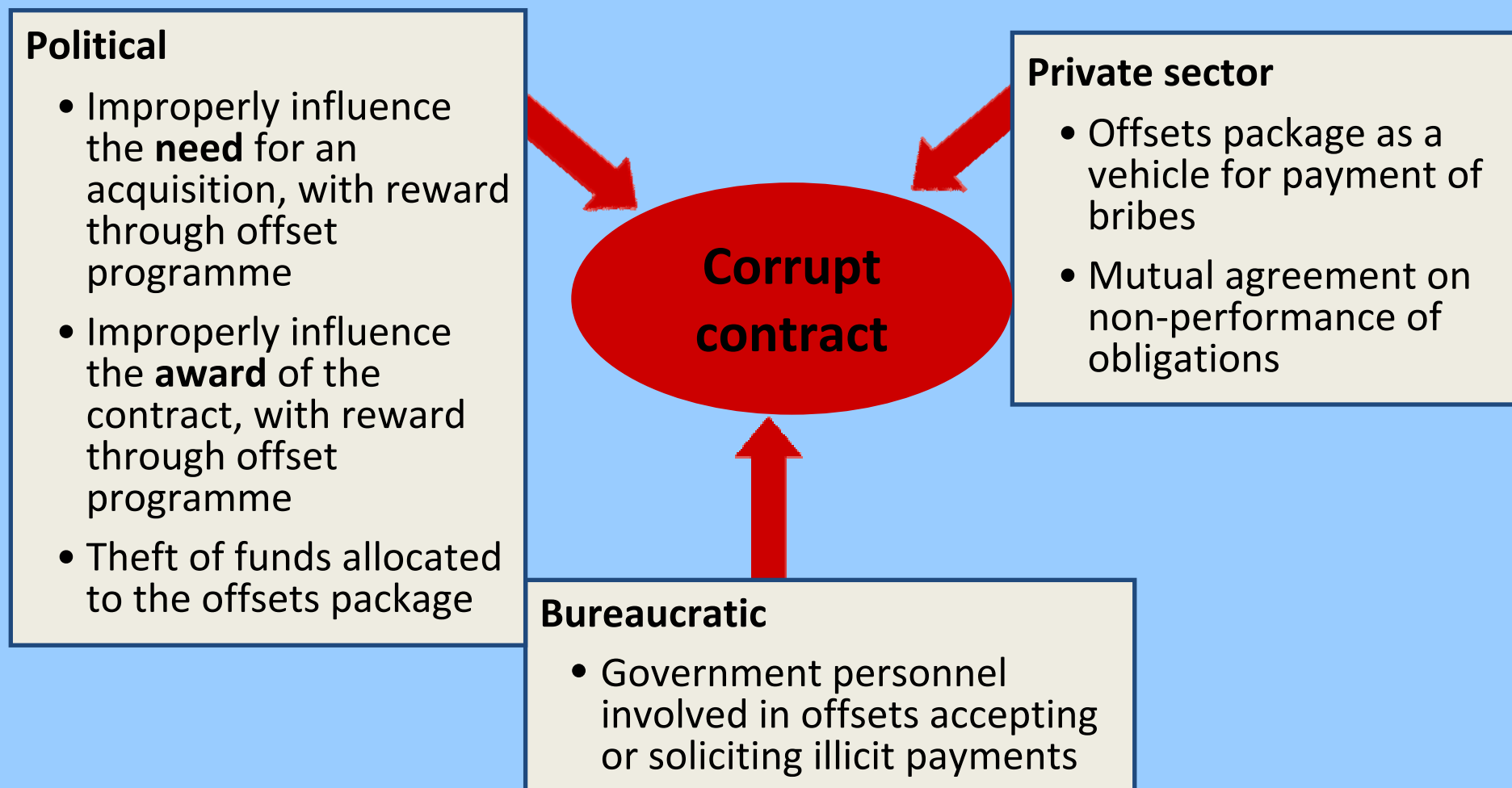
*TI Bribe Payer's Index, 2002; US DoC*

## It matters...

Misuse and waste of public funds ... Deteriorating operational effectiveness  
 ...Loss of public trust ... Invalidation of national security strategies.

# Offsets : Corruption Risks

**Corruption: Confined to offsets OR in broader procurement cycle**



**Lack of transparency, monitoring, evaluation, incentivization and, often, project completion**



# Case 1: South Africa



1999 Arms Deal to purchase high-tech warships, aircraft, and submarines, costing \$4.8 billion. Included ambitious offsets programme to create 65,000 jobs and generate R111bn revenue.

Stated benefits of offsets under big question. Allegations of senior figures in government receiving bribes and succumbing to conflicts of interest when awarding offsets contracts.

Allegations highlight offsets' risks:

- Offset programmes used to influence award decisions
- Bribery, poor transparency, inadequate due diligence, conflicts of interest



## Case Study 2: Portugal



Submarine acquisition from GSC contains country's largest offset programme (EUR1.2 bn )

Portuguese prosecutors indicted ten (national & foreign) executives of fraud and forgery in offsets programme

Prosecution's claims: colluding obligor and Portuguese consortium included projects lacking causality/existing investments in offset programme; vehicle for bribes;  
**damages to state ca. EUR34mn**

This prosecution:

- Highlights responsibility of those managing offsets, whether in suppliers, beneficiaries and governments
- Highlights the need for robust and traceable evaluation and integrity mechanisms

# Promoting Integrity in Offsets

## Government - policy

1. Make transparency, strategic security central to national offsets policy
2. Have realistic expectations re offsets' benefits
3. Consider requiring two prices: with and without offsets
4. Engage civil society in oversight of offset performance and governance
5. Require specific monitoring provisions in offsets contracts; value for money audit and independent evaluation after each offset programme
6. Require annual publication of offset obligations (exporting governments), performance and benefit
7. Create stronger incentives for timely completion/execution of offsets contracts by companies

**For EU: Implications of Defence Procurement Directive, EDA Code of Conduct on Offsets**

# Promoting Integrity in Offsets

## Government – resourcing & responsibility

1. Build staff capability with experienced, specialised offsets personnel
2. Treat offsets staff as holding sensitive procurement positions → carry out due diligence; require adherence to specific conduct & disclosure requirements
3. Carry out a review of concerns/issues from past offset performance





# Promoting Integrity in Offsets

## Companies and Defence Industry associations

1. Companies: active approach; address risk explicitly through internal codes of conduct and in the compliance programme
2. Companies: extend due diligence, compliance standards to offset intermediaries and third parties
3. Defence industry association: be proactive in promoting transparency in offsets contracts. eg:
  - *Developing and publishing guidance on high transparency/high integrity standards and approaches. Promoting discussion and education through industry workshops*
  - *Amending codes of conduct to incorporate offsets corruption risks*

# Conclusions

- ▶ Corruption risk in offsets is high and important to address (enfeebled capabilities, wasted public funds, loss of trust)
- ▶ The climate is changing and progress being made
- ▶ Corruption risk can be addressed like other risks: Clear leadership, strong and public transparency requirements
- ▶ Companies, defence industry associations and governments agencies should be proactive – it is a solvable issue

Julia Muravska ♦ [julia.muravska@transparency.org.uk](mailto:julia.muravska@transparency.org.uk)  
 +44 20 7785 6402 ♦ [www.defenceagainstcorruption.org](http://www.defenceagainstcorruption.org)  
[www.transparency.org](http://www.transparency.org) ♦ [www.transparency.org.uk](http://www.transparency.org.uk)

