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Public-private relationships in defence procurement in the EU: The case of the UK

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Executive summary

Defence procurement is sensitive to corruption and state capture risks, because the government enforces secrecy and awards high value contracts to firms in a market dominated by a few large players (Pyman, Wilson & Scott, 2009; Courtney, Cockcroft & Murray, 2002). Defence procurement in the UK has some additional risks considering that around 50% of its contracts are awarded without competition. Although the UK has low levels of corruption risks in its defence sector compared with other EU member states, there are still certain issues that cause concern. For example, survey evidence suggests that businesses in the UK think that too close ties between politics and business lead to corruption (Eurobarometer, 2017), while the national public opinion survey suggests that almost 80% of respondents consider the revolving door phenomenon as a possible example of corruption (Barrington, 2010). The available data indicates that the revolving door is a common practice in the UK, especially in the defence sector. Namely, the data of the Advisory Committee on Business Appointments (ACOBA) suggest that the highest number of requests for movements from the public sector came from the Cabinet Office and the Ministry of Defence (MoD) in the last two years (ACOBA, 2018, p. 6).

Over the last decade, the UK expressed a strong commitment to tackle some of the most pressing concerns in its defence acquisition process, related to achieving better value for money (VFM) and increasing the scrutiny of non-competitive contracts. Namely, it abandoned the outdated Yellow book regime that was used to control for an excess profit in single sourced defence procurement for more than 40 years and replaced it with a statutory framework under the Defence Reform Act of 2014. Although the UK has developed a strong institutional framework that can tackle corruption risks in its defence acquisition process, this report will demonstrate that certain risks remain, especially with regards to the revolving door, the scrutiny of single sourced contracts and achieving better VFM.

This paper relies on both quantitative and qualitative data in analyzing major corruption and state capture risks in the defence procurement process in the UK. After an introductory section, the paper addresses relevant literature outlining the most pressing risks in defence procurement. I first offer a conceptualization of state capture as a multirelational phenomenon, that can capture the relevance of both political and business actors and their interaction in the defence acquisition process. Next, I stress that some outcomes of the defence procurement process (e.g. cost overruns, lack of competition) derive from characteristics that are inherent to the defence sector itself, such as the complexity of high technology equipment involved and the market structure. However, it is important to recognize that the aforementioned outcomes can signal potential corruption and state capture risks. Namely, close ties between the government and the industry established through the revolving door and decades of cooperation can put certain companies in favorable positions at the expense of competition and of achieving best VFM in defence procurement contracts.

In section three, I analyze the institutional and legal framework around defence procurement in the UK, by looking at a) the evolution of institutional reforms and b) the most important issues that remain for



defence procurement process in the UK in the current institutional context: achieving better VFM and improving the scrutiny of non-competitive contracts. Despite the attempts to improve the control of single sourced contracts under the new statutory regime, the data suggest that a big portion of non-competitive contracts remains beyond the scope of the new regulatory framework (House of Commons Defence Committee, 2017).

The empirical part of the report, first, explains the market landscape with regards to both the demand and supply side, by identifying the most important actors and their market share in the UK's defence sector landscape (section 4). Section that follows addresses the case of UK using quantitative data collected from the official EU procurement webpage Tenders Electronic Daily (TED). I distinguish between issuers and suppliers based on their Corruption Risk Index (CRI), which is a composite index from the literature, quantifying the presence of red flags in the award and performance of procurement contracts (Fazekas, Tóth, and King, 2016). The analysis suggests that CRI in the network connecting issuers and winners of contracts is centralized and clustered in specific parts of the network. There is a clear distinction between prime contractors and smaller companies with regards to their CRI. Namely, prime contractors are in the category of high CRI. On the issuing side, the MoD appears in both high and low CRI contracts, while regional and local level organisations tend to cluster in low CRI contracts.

Informed by both the analysis of the institutional framework of defence procurement in the UK and the quantitative analysis, in Section 6, I rely on semi-structured interviews with key defence procurement experts and the main actors involved in the defence procurement process to identify the most pressing corruption and state capture risks. I find that the most challenging risks in the UK context relate to: a) the revolving door – the movement of individuals between public and private sector positions, b) the scrutiny of non-competitive contracts and b) post-award contract performance, with regards to monitoring, contract delays and cost overruns. The revolving door carries both benefits, with regards to improving communication between government and industry in the context of complex research and development (R&D) projects, for example, and corruption risks, when these networks are merely used as an access point for companies to get preferential treatment or an access to commercially sensitive information. Considering that the revolving door, beside corruption and state capture risks, provides benefits, one of the aims of this paper is to formulate policy recommendations that would minimize the corruptive risks of it, while preserving its beneficial effects in the context of the UK.

Evidence suggests that post-award performance in large contracts has been a problem in the UK: there are cost overruns, problems with contractor performance and contract delays, influenced by poor project monitoring, but also by occasional political interference. Even though some of these problems are inherent to the complexity of the largest projects in the defence sector, there are corruption and state capture risks that require closer attention, as I demonstrate in the second part of Section 6.

After the concluding section, which summarizes the findings of this paper, in Section 8, I build on the previous findings to put forward three main policy recommendations:

- *The UK should develop a database that could be used to assess the effects of the revolving door on its defence acquisition process, as detailed in Section 8. This database should be published and regularly updated on the ACOBA webpage. This data would enable better understanding of*



both positive and negative effects that the revolving door has on the defence procurement process in the UK, especially with respect to the timeliness of contracts and VFM. Consequently, this would help in devising future data-driven suggestions for changes in the regulation of the revolving door.

- *The responsibility of ACOBA to monitor business appointments of Crown servants below Director-General level (below SCS3 level) should be reintroduced.* This is necessary because individuals at junior levels are involved in the negotiation process for defence contracts and have access to commercially sensitive information. Considering that junior level individuals are also moving from the public to the private sector, and that the general trend of these movements has increased in the last 10 years, it is vital to monitor these transitions as well.
- *The decision of the Secretary of State for Defence about procuring single-sourced rather than competitively should be clearly elaborated and justified, and the decision then scrutinized by SSRO. The justification about the decision should be made publicly available.* Considering the value of non-competitive contracts in the UK, it is essential to put them under stronger scrutiny. This is because the new SSRO regime, although it sets out to improve the monitoring of non-competitive procurement contracts, still lacks the capacity and authorities to fully control these contracts. Moreover, current justifications by project teams about decisions to procure non-competitively vary significantly in their quality (NAO, 2017).



1. Introduction

Academic and policy-oriented studies suggest that public procurement contracts are sensitive to corruption (Fazekas & Tóth, 2014; Macaulay, 2011). Corruption can occur in various stages of procurement process: in the pre-bidding stage when requirements may be tailored to specific companies, in the bidding phase, by lacking adequate justification for using non-competitive tendering and in post-award phase in terms of contract renegotiation to increase the profit of the contract winner, for example (OECD, 2016). The consequences, among others, include the lower overall quality of goods and services provided, and a failure to achieve value for money (VFM) for taxpayers (OECD, 2016). Corruption in defence sector potentially carries even bigger risks than in other fields, considering that defence relates to issues of national security, that governments as the biggest buyers tend to enforce secrecy and that the market landscape is dominated by a small number of prime contractors (Courtney et al, 2002; Roberts, 2004; Fish & Man, 2016).

The UK is in the top five countries based on defence budget, and over the last 9 years it managed to keep up with the NATO target of spending 2% of its GDP on defence (Dempsey, 2018). The UK's Strategic Defence and Security Review (SDSR) of 2015 outlined spending of £178 billion on equipment and equipment support over the period of 10 years (SDSR, 2015).

The UK has comparatively low levels of corruption. Based on Transparency International (TI) Corruption Perception Index of 2018, it is ranked 11th out of 180 countries². It is also ranked among countries with a low risk of corruption in defence and security sector, according to the TI Government Defence Anti-Corruption Index³. The UK is a signatory of relevant anti-corruption conventions, such as OECD Convention on combating bribery of foreign public officials in international business transactions, the UN Convention Against Corruption and the Council of Europe Criminal Law Convention on Corruption.

Nevertheless, aspects of the UK defence procurement market cause concern. In the national opinion survey on corruption in the UK, only a quarter of respondents thought that the government is effective in fighting corruption. Moreover, when asked about revolving door scenario - which is a frequent occurrence in the defence sector – namely, whether they think that when a public official takes a job at a private company that he/she was previously responsible for regulating is a possible example of corruption, 80% said yes (Barrington, 2010). Moreover, some surveys on businesses in the UK also reveal the existence of perceived corruption. Namely, in a Eurobarometer survey of business in 2017, 28% of companies in the UK answered that the problem of corruption is fairly widespread, while 33% answered that favoring friends and family members in business is the most widespread compared to 6 other options⁴ (Eurobarometer, 2017). Also, 61% said that they totally agree that too close links between business and politics lead to corruption, while 28% percent of companies answered that in the last three years

² Available at: <https://www.transparency.org/cpi2018>.

³ Available at <http://government.defenceindex.org/countries/united-kingdom/>.

⁴ The other options that were offered were: Favoring friends and family friends in public institutions, Funding political parties in exchange for public contracts or influence over policy making, Tax fraud or non-payment of VAT, Offering a free gift or trip in exchange for a service, Bribes, Kickbacks (Eurobarometer, 2017, p. 40).



corruption has prevented them from winning a public tender or a public procurement contract (Eurobarometer, 2017).

Thus, although the UK has comparatively low levels of corruption, the above outlined results suggest that there is a room for improvement. Moreover, as we will see further, our data on defence procurements in the UK, suggest that there is a variation in corruption risks among defence contracts, which calls for a careful analysis.

2. Literature review

This review summarizes the main studies relevant to the defence procurement process in the UK in the context of corruption and state capture risks. I first propose to conceptualize state capture as a multirelational phenomenon, that exemplifies the relevance of both political and business actors and their interaction for the defence procurement process. Second, I discuss studies that suggest characteristics of defence acquisition process that make it prone to corruption and state capture, such as large value contracts, enforcement of secrecy and the nature of defence market. Finally, I emphasize that some risks that arise in defence procurement are inherent to the nature of the industry, while others can be a consequence of relational ties between government and industry.

State capture phenomenon has traditionally referred to the process in which business actors coopt the state to achieve narrowly distributed outcomes (Hellman, 1998; Hellman, Jones, & Kaufmann, 2003). However, the empirical research has shown that unidirectional understanding of this process does not adequately describe the empirical reality. First, the state is not a black box (Guthrie, Okhmatovskiy, Schoenman, & Xiao, 2012). Rather, it is necessary to unpack the relevant actors within the state to understand the process better. For example, a study by Fazekas, Ferrali and Wachs (2018) documents the links between campaign contributions of firms to political parties in the US and corruption risks in contracts that these firms win. Second, business actors are not uniform. To take the defence industry as an example, there is a big difference in the market power between big prime contractors specialized for defence and companies that produce components for the final product. Third, state capture is better understood as a multirelational phenomenon that suggests that both the state actors and the business influence different outcomes. The revolving door precisely exemplifies this understanding, because it shows how are relational ties established between government and industry.

The risks of state capture are especially salient in the defence procurement sector because of some important aspects of this industry. The literature on corruption and state capture risks in defence procurement in the UK is scarce and mostly consists of policy-oriented studies. The literature in general outlines several reasons that make defence procurement tenders susceptible to corruption, and these include relatively low number of large contracts, the enforcement of secrecy by the government as well as the large value contracts involved (Pyman et al, 2009; Courtney et al, 2002; Roberts, 2004). Additionally, single sourced contracts, which account for around 50% of the UK's defence contracts are especially prone to corruption risks. Close links between government and industry, established through the revolving door and years and decades of cooperation, can lock big prime contractors into



advantageous positions, in which they accumulate advantages by having a preferential access to information and new contract opportunities. As Pyman and collaborators argue, in contexts where single sourced contracts are present, procurement officials have power to decide which companies will be awarded the most lucrative contracts through their timing, specifications, or other properties. Consequently, there is a need for strong rules and guidance for the competitive process to avoid opportunism occurring in the decision-making phase (Pyman et al, 2009, p. 218).

The nature of the defence market can also have a crucial effect on important outcomes, such as cost overruns. As defence is a monopsonic market, characterized by one dominant buyer – the government, this buyer can influence various industry features, such as ownership, entry and exit, industry size, etc. (Hartley, 2016). In the UK, the defence industries are characterized by asset specificity. Namely, it is very costly to make changes once an equipment specification is completed (Hartley, 2016). A good case in point is the contract with Capita Business Services Ltd (Capita) of 2012 to recruit new soldiers into the British army. The cost of the contract increased by 37% mainly because of the additional costs of developing the online system for recruitment and the revision in approach to recruitment (NAO, 2018).

It is important to note that cost overruns can occur because of some features that are inherent to the defence procurement process, and thus result in failure to achieve value for money (VFM). Namely, for complex projects that involve research and development (R&D), it is challenging to assess in advance all financial aspects of the contract. Some policy-oriented studies exemplify the main potential risks that defence sector procurement tenders, due to their specific nature, bring. Namely, national security may be used as a justification for secrecy, supply chains tend to be long and contracts lengthy, taking sometimes years to negotiate and complete, while the high technology products require specific expertise (Fish & Man, 2016).

To sum up, the defence industry has some characteristics that make it especially prone to state capture and corruption risks. Namely, defence industry has some features that encourage secrecy, lack of competition and poor performance in achieving VFM. Having a large proportion of single sourced contracts, the UK has additional risks in its defence acquisition process. Therefore, the following sections will analyze the defence acquisition landscape in the UK for potential corruption and state capture risks, considering the details mentioned above.

3. Institutional framework of defence procurement in the UK

This section has a purpose to explain the institutional and legal framework that guide defence procurement in the UK and, considering the specific nature of defence sector and risks that are inherent to it, to set a context for the analysis of corruption and state capture risks in sections that follow. This section first addresses the main specificities of defence procurement in the context of the UK. Next, I explain the legal framework for defence procurement and the existing regulatory and auditing environment and capacity relevant for the defence sector. I continue by focusing on the most important institutional reforms with regards to defence acquisition process in the UK. Namely, I discuss: a) the



main governmental reports that focused on improving defence project performance and value for money (VFM), b) some of the main reasons behind failures to achieve VFM in the past and institutional changes that were introduced to improve the scrutiny of non-competitive contracts by replacing the voluntary Yellow book regime with the new statutory framework and c) changes in budget allocation for defence procurement and their potential effects on defence acquisition process in the UK.

3.1 Characteristics of defence procurement process in the UK

Defence procurement contracts have important specificities that differentiate them from general procurement in a way that distorts competitions and leads to short falling VFM. First, in large EU member states such as the UK and France, the “technology advantage principle” creates a unique environment for defence procurement. Namely, to develop a superior technology, a country needs to engage in a lot of research and development (R&D) (Ministry of Defence, 2012). This is an argument for nurturing a close cooperation between the government and the industry, especially for those countries that do not rely on buying goods off the shelf. As the former RAF officer explained in the interview:

We are absolutely reliant upon a lot of technologies, capacity, that exist within private sector, so it’s very difficult to make a case for anything other than complete interdependency. Government is reliant to private sector for its capacity and competence, and private sector is reliant to government for its patronage and its requirements. The two are absolutely interwoven. (Interview 1)

Moreover, the complexity of high technology projects, such as the renewal of the UK’s nuclear deterrent and development of new nuclear submarines, makes it harder to precisely specify the contract (Bond & Pfeifer, 2019). Consequently, these kinds of contracts are at the highest risk of delays and cost overruns.

Second, the market structure in the defence sector tends to be dominated by one buyer and one or few large contractors, called “primes”, forming a market monopoly or oligopoly (Georgopoulos, 2015). The defence market in the UK, particularly for high technology equipment, such as submarines and aircraft, is dominated by a small number of large contractors (De Fraja & Hartley, 1996). On the demand side, the Ministry of Defence (MoD) is the single biggest buyer in the UK.

Third, the defence sector is specific because it involves considerations that are, broadly speaking, of importance to national security. Countries often procure non-competitively for reasons of security and secrecy. Other justifications include staying with the same design team for maintaining the product and achieving “freedom of action” referring to the ability to conduct operations without being dependent on other states (Currie, 2011).

These characteristics are important to have in mind when analyzing the potential corruption and state capture risks in the defence procurement sector. This is because one needs to understand the features that are inherent to the defence sector to be able to formulate recommendations that would minimize the state capture and corruption risks, while being fully aware of the (market) context in which they occur.



3.2 The legal and auditing framework of defence procurement in the UK

Procurement of defence and security equipment in the UK is regulated by the Defence and Security Public Contracts Regulations (DSPCR) of 2011, that transposed the EU Defence and Security Directive (2009/81/EC) into UK law. These procurements are governed by principles of transparency, equal treatment and non-discrimination, with the exception when essential interests of security are at stake (MoD, 2012, p. 30). These can range from security of information to research and development (R&D). Namely, as stated in the White paper of the MoD, *National Security through Technology* and in the latest strategic review, the UK is committed to open competition for defence and security equipment, except when they need to protect their operational advantage and the freedom of action (MoD, 2012, p.8; SDSR, 2015).

The DSPCR applies to military equipment and associated works, goods and services, sensitive security equipment and works and services for military purpose (2011a). The regulation requires that in the case of mixed procurements, DSPCR applies, unless the Treaty⁵ exemption or exclusion can be used (2011b). The financial thresholds in the DSPCR, exclusive of VAT, are £363,424 for goods and services and £4,551,413 for works (2011c). The DSPCR sets out four main procedures for procurement: a) restricted, b) competitive procedure with negotiation, c) competitive dialogue and d) negotiated procedure without previous publication (2011d). As we will see below, our data collected from Tenders Electronic Daily (TED) suggests that restricted procedure was the dominant one used in defence procurement tenders in the UK between 2006-2016.

The DSPCR specifies the conditions under which the requirement can be procured single sourced: a) competition is not possible due to exclusive rights (e.g. one supplier has intellectual property rights), b) where in previous competitive tender, there were no other interested bidders, c) on grounds of urgency, d) for research and development (R&D), e) for limited additional deliveries of original supplier, f) for supplies purchased on commodity market or on advantageous terms, after insolvency event, g) for limited repetitions of works from the original supplier, and h) based on exclusions in DSPCR (2011e). For single sourced contracts, the UK applies the Single Source Contracts Regulations of 2014, as we will see in detail in the following section.

The overall commitment of the UK, as stated in their strategic documents is towards enabling the best capabilities for their armed forces at best VFM. The defence policy of the UK is scrutinized by several relevant bodies. The Defence Select Committee is an 11 members body appointed by the House of Commons, that has an authority to examine the expenditures of the MoD. The National Audit Office

⁵ Article 346 of the Treaty on the Functioning of the European Union (TFEU) sets the most relevant exemptions for those procurements that fall under DSPCR regulations, and which allow to procuring authority to withhold information that otherwise might jeopardize security interests of the UK. More information: https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/670566/20171215-DSPCR_Chapter_04_Treaty_Exemptions_Dec_17_Edn.pdf



(NAO) publishes regular reports on expenditures of MoD and specific case studies that deal with defence procurement process, VFM and affordability of the UK's defence plans. The UK also has several other committees that engage with defence. For example, the Public Accounts Committee (PAC) investigates public spending including defence spending. The UK has strong anti-corruption policies, reflected in the Bribery and Fraud Acts. In its Anti-Corruption Plan of 2014, the issue of procurement is addressed and the commitment to transparency emphasized, by stressing the danger of corruption in defence industry, considering its importance for keeping citizens safe. The Anti-Corruption plan mentions the establishment of MoD Fraud Defence Board which focuses on prevention, risk, awareness, detection and enforcement (HM Government, 2014, p. 34).

3.3 Institutional reforms of the defence acquisition process in the UK: Attempts at achieving better VFM and improving the scrutiny of non-competitive contracts

For a long time, defence procurement in the UK has been dominated by the so-called Yellow book regime, established in 1968. This was an arrangement between Treasury and Confederation of British Industry aimed to improve the control over the excess profit in non-competitive defence procurement contracts (House of Commons Defence Committee, 2017). It was eventually realized that this regime is outdated, because it fails to incentivize either VFM or efficiency of contractors. Namely, in the foreword to the document *Better defence acquisition*, the Secretary of State for Defence Philip Hammond noted that for 20 years, the UK's defence equipment program has been characterized by waste and cost overruns (2013). This document proposed to create a new statutory framework for non-competitive contracts and a new operating model that would replace Defence Equipment and Support (DE&S), the organization that manages acquisition strategy and process, with the so called GOCO (Government Owned Contractor Operated), an entity that would be under government strategic control, but operated by the private sector (MoD, 2013). The former has been achieved, while the Government gave up the latter, because it received only one bid from the industry (NAO, 2015). Rather, the decision has been made to establish DE&S as a bespoke trading entity.

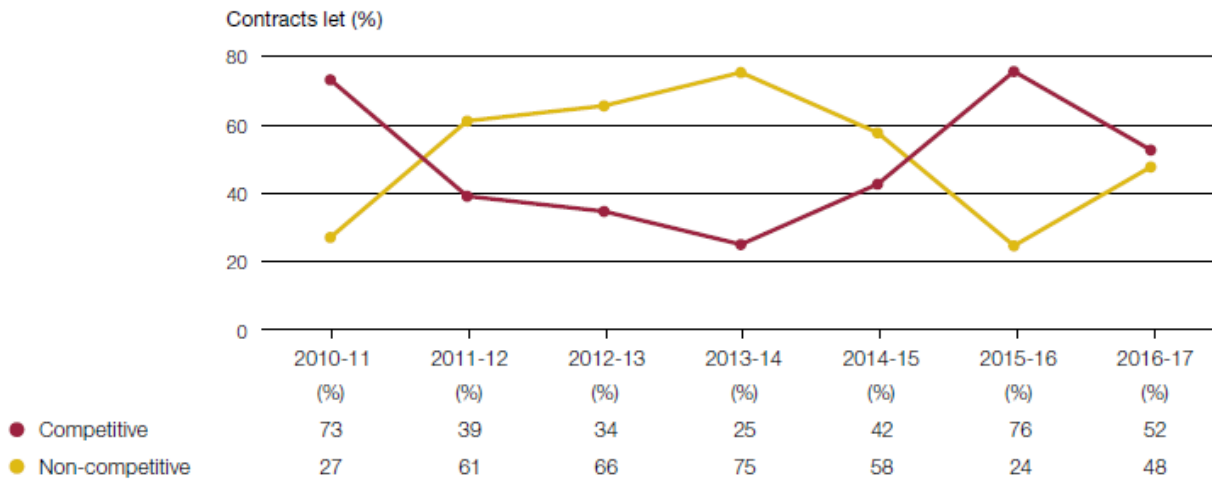
Lord Currie, in his report, that reviewed the then existing single-source framework, identified the main problems with the Yellow book arrangements, which included the focus on profit rate, rather than on the cost base (Currie, 2011). Single sourced contracts account for more than 50 percent of all defence procurement tenders in the UK, and the UK has spent £8.8 billion (VAT exclusive) on these contracts in 2015-2016⁶. (NAO, 2017; MoD, 2013). The value of single sourced contracts varies significantly. For example, as shown in Figure 1, the value of non-competitive contracts annually varied from 24 to 75% of the value of contracts let from 2010 to 2016, based on the NAO analysis of departmental data.

⁶ Between 2007/08 and 2011/12, the single sourced procurement contracts averaged more than £6 billion per year (MoD, 2013, p. 7).



FIGURE 1. COMPETITIVE AND NON-COMPETITIVE CONTRACTS BASED ON VALUE BETWEEN 2010/11 AND 2016/17. SOURCE: NAO, 2017, P. 19.

The share of non-competitive and competitive contracts by value can vary strongly from year to year



Notes

- 1 Contracts are shown by year let.
- 2 Excludes contracts with the Department's Defence Science and Technology Laboratory, pan-government contracts, cross-departmental services and contracts let by the Defence Infrastructure Organisation.
- 3 Contracts stated as active on the Department's database as at 31 March 2017.

Source: National Audit Office analysis of departmental data

Some of the major defence purchases in the UK are single sourced: Type 45 destroyers and Typhon fast jets, to mention two examples (House of Commons Defence Committee, 2017). Some of the corruption and state capture risks of single sourced contracts were in large part due to the specific relationship between MoD and big defence contractors, considering that they both have a high market power (Currie, 2011). Namely, as evidenced in the NAO report about improving VFM in non-competitive contracts, commercial teams indicated that some suppliers wanted to impose their terms in the past because of the strength of their market position (2017, p. 33).

The data suggest that MoD over years failed to achieve VFM. Namely, there were cost overruns, delays, etc. For example, the biggest discrepancy between original and current forecast cost for 17 mayor equipment projects is for Queen Elizabeth Class Aircraft Carriers and for the Lightning II, as the MoD data demonstrate (MoD, 2018a, p. 4). The financial pressures have been recognized in the latest Defence Equipment Plan, and the commitment to work on addressing the risks of affordability, was expressed (MoD, 2018b). As one defence audit expert explains the reasons for failure to achieve VFM in the past:

Part of that has been poor contracting performance, part of that has been poor management from the MoD side, in terms of acting as an intelligent customer, part of that has also been the customer constantly changing his mind about what he wants, and some of that is inevitable because it's fast moving world where the enemy is constantly improving - say anti-submarine



detection - so they constantly have to upgrade what is it they build into submarines. Every astute submarine has been very different. (Interview 2)

Additional reasons noted in the MoD report on single source defence acquisitions were poor project control by the DE&S and a lack of understanding of cost drivers (MoD, 2013). Moreover, poor performance and cost overruns are in part due to so called “conspiracy of optimism” between military issuers/requesters and industry (MoD, 2013). As one defence industry expert explained:

The person writing requirements has to get the requirements prioritized by the Treasury. So, the person writing requirements is pressured to say: ‘we have this system, but it’s getting old. If we get a new system, it would be really wonderful.’ If he says: ‘it is slightly better than the old one’ you say, ‘well, just get more of the old one’, so he is pressured to say it would be really wonderful. And the person writing the bid from the industry is under pressure, because although the MoD talks about best value, they always take cost very central, they are under pressure to say we can do this wonderful thing and we can do it for not much money. That enhances your chances to get the Treasury approval. Then you say, ‘look, companies indicate they can do this for nothing, and it’s going to be great’ - both sides generate blind sheets. (Interview 3)

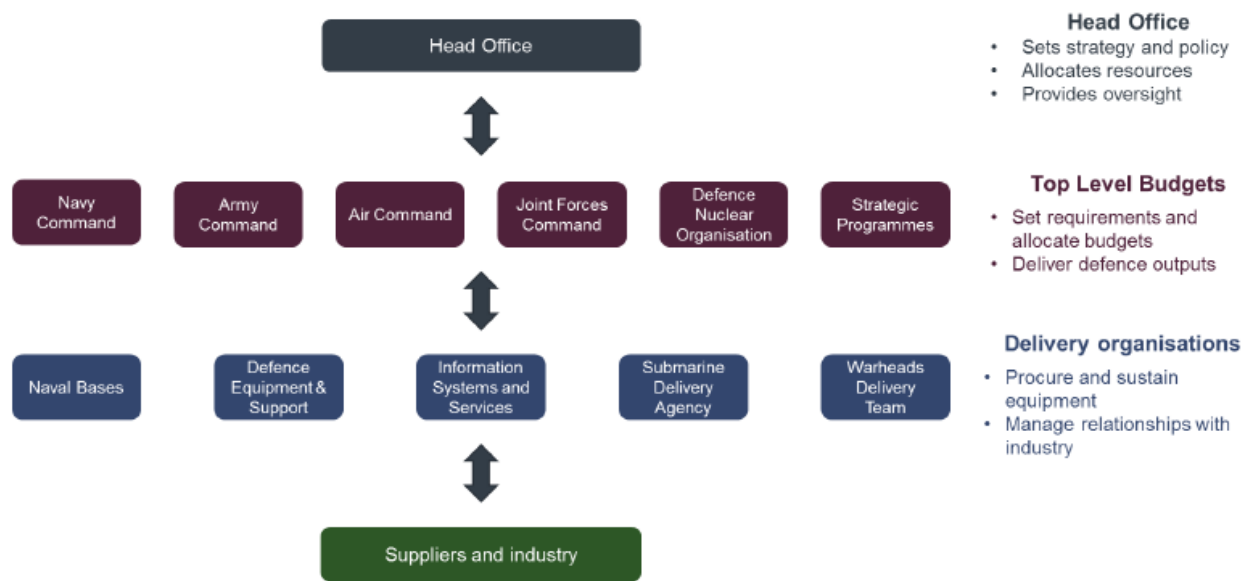
There were several reports over the last decade in the UK that specifically looked at the organizational structure of the Ministry of Defence (MoD) and at the defence acquisition process, with an aim to suggest improvements to the MoD organizational structure and of defence procurement (Gray, 2009; Levene, 2011; Currie, 2011). Lord Levene reviewed the structure and management of MoD and found that defence acquisition system was under-performing and that there was an over-heated support and equipment program (Levene, 2011; MoD, 2013). Lord Currie’s report aimed to propose concrete steps that would help to achieve VFM in single sourced contracts and a fair return for the industry. (Currie, 2011). He proposed setting up of Single Source Regulations Office (SSRO) which would regulate non-competitive defence procurement contracts. Finally, the voluntary approach of the Yellow book was replaced with a statutory one, outlined in the Defence Reform Act of 2014. Under this act, SSRO was established as a non-departmental public body, in charge of regulation of non-competitive qualifying defence contracts (QDC) and qualifying sub-contracts (QSC) above the threshold of 5 million pounds for QDCs and above 25 million for QSCs (in case they are subcontracts of QDC), for contracts after March 31, 2015 (SSCR, 2014). SSRO develops a new profit rate methodology, submits it to Secretary of Defence for approval, and also gives guidance on allowable costs and opinions in case of disputes (NAO, 2017, p. 26).

However, despite greater attention to scrutinizing single sourced contracts, a big portion of these contracts remained beyond the scope and reach of SSRO. For example, based on the SSRO report of 2015, only 15-20% of MoD expenditure for single sourced contracts was within the scope of the new regulations (House of Commons Defence Committee, 2017). Namely, government-to-government contracts, contracts for purchasing the existing land and buildings, international collaborative contracts and those that solely refer to intelligence are excluded from the SSRO’s scope (NAO, 2017). Moreover, SSRO is not an independent regulator, and it has no enforcement power (House of Commons Defence Committee, 2017). Furthermore, the potential rationales for deciding to procure particular contract non-competitively remain unclear (Georgopoulos, 2016). This raises concern of the possibility for an unjustified exclusion of competition.



The changes were also made in terms of budget allocation for defence acquisitions. Starting from 2014, Head Office leads Defence, while the budgetary responsibility for equipment and support was delegated to the four Front Line Commands of Navy, Army, Air, and Joint Forces Command, the Defence Nuclear Organisation and Strategic Programmes, who became top level budget holders, as illustrated in Figure 2. They became responsible for setting equipment procurement and support requirements. The Plan is then delivered by delivery organizations, who procure and manage relationships with the industry (MoD, 2018b; NAO, 2017). Budget allocation and budgetary constraints are important factors that can influence corruption risks in defence procurement, as the literature suggests. Namely, tight budgetary constraints might influence ministries to pursue more competitive procurement, to achieve best VFM, as argued by Pyman and collaborators (2009). As we will see in greater detail below, the above-mentioned structural reconfiguration of budget allocation in the UK seems to influence the way that Front Line commands procure.

FIGURE 2. THIS IS THE ORGANIZATION AS OF 2014 UNDER THE DEFENCE OPERATING MODEL. SOURCE: MOD, 2018B, P. 9.



In sum, the UK has a strong and robust legal framework and auditing capacity for the defence acquisition process. Moreover, the UK has made important progress in scrutinizing its defence procurement process over the last decade, especially with regards to non-competitive contracts and attempts were and are being made in achieving better VFM. Some of the risks that arise in defence procurement in the UK are inherent to the nature of defence market and to specific contracts (e.g. research and development (R&D)). However, state capture and corruption risks, especially related to single sourced contracts remain, considering that a large portion of these contracts remains beyond the scope of SSRO.



4. Defence procurement market in the UK: issuers and suppliers and their consolidation

On the procuring side, the single biggest buyer in the UK, as in most countries, is the Ministry of Defence (MoD). Other entities also appear for example, regional or local authorities, such as Yorkshire Purchasing Organisation (YPO) and different police departments. YPO is a central purchasing body, established by 13 local councils, that procures on behalf of various customers, including local authorities, emergency services, public sector.

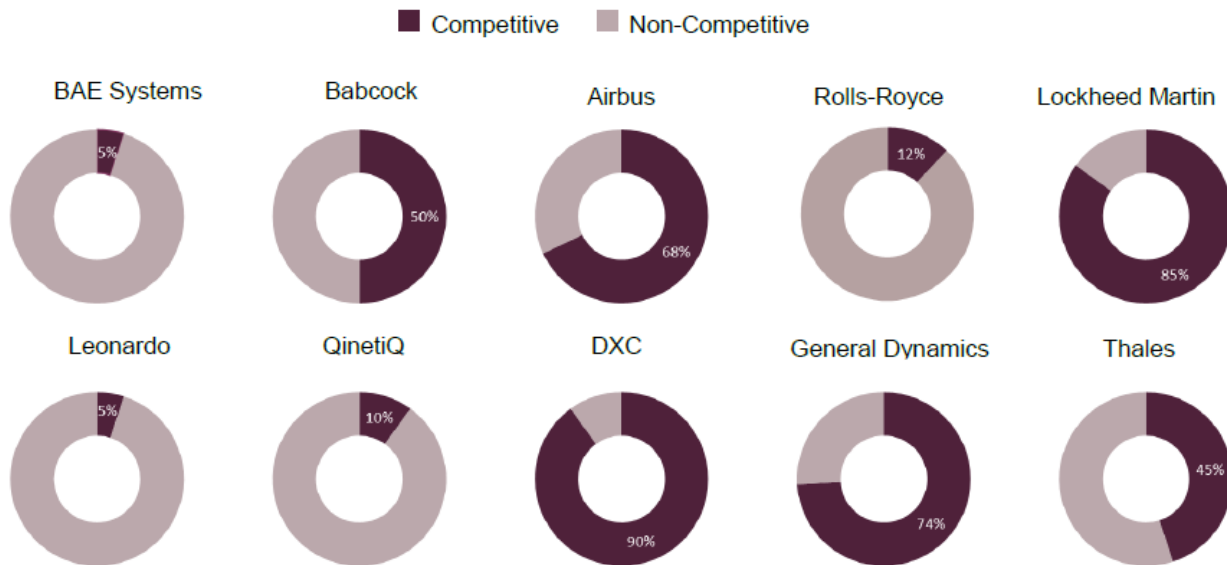
On the supply side, the UK defence market has been characterized by consolidation over the last three decades. It started with privatization in the late 1980s, when important national champions, such as British Aerospace (BAE), Royal Ordnance, British Shipbuilders, and Rolls-Royce, were privatized. Soon enough, the defence landscape, especially for high technology equipment, such as submarines and aircraft, became dominated by a handful of companies for example, BAE Systems Plc and Rolls Royce (De Fraya & Hartley, 1996).

Further consolidation occurred in the early 2000s. For example, BAE acquired Alvis Vickers in 2004 and Armor Holdings in 2007; QinetiQ acquired Westar corporation in 2004 and Broadreach Networks Ltd in 2005; Rolls Royce took over Optimized Systems and Solutions Llc in 2006; Babcock International Group Plc acquired Peterhouse Group Plc in 2004 and Alstec Group Ltd in 2006, to mention some examples (Currie, 2011, p. 103-104). If we observe the departmental data analyzed by NAO about the biggest contractors based on the revenues from single sourced contracts as at March 2017, we can see that BAE dominates the landscape with the value of over £14.6 billion for 121 contracts, followed by Rolls Royce and Babcock International⁷ (NAO, 2017, p. 22). Some earlier statistics for single sourced contracts show that between 2007-2011, only 7 contractors have accounted for 80% of the contract value let (Currie, 2011, p. 103).

BAE Systems Plc is the biggest defence supplier of the MoD, based on the MoD's annual spend, over the last decade. According to data for 2017/18, BAE was awarded 14% of all defence procurement expenditures of the MoD (MoD, 2018a, p. 9). Based on SIPRI list of Top 100 arms and military services companies of 2014 worldwide, BAE was in the third place, while the next best British company was Rolls Royce, as 16th (SIPRI, 2016). Moreover, only 5% of MoD's revenue from BAE in 2017/18 came from competitive contracts, as shown in Figure 3.

⁷ As written in the NAO report, this data excludes "contracts with the Department's Defence Science and Technology Laboratory, pan-government contracts, cross-departmental services and contracts let by the Defence Infrastructure Organisation". (NAO, 2017, p. 22)

FIGURE 3. THE SHARE OF COMPETITIVE AND NON-COMPETITIVE CONTRACTS FOR THE BIGGEST DEFENCE CONTRACTORS. SOURCE: MOD, 2018A, P. 11.



Source: Defence Statistics analysis using DBS Finance data sources

5. Data sources and analysis

To explore corruption and state capture risks in the UK defence market, this report relies on both quantitative and qualitative sources. First, the quantitative data is based on contracts that were collected from the database Tenders Electronic Daily (TED), the official EU portal for contract announcements and awards. This database includes the information on the names of issuers and winners, estimated and the final value of the contract, title of the tender, the publication date and the deadline to submit a bid, the procedure type. In addition, we used manually collected defence procurement data that were collected from journal articles, NGO reports, parliamentary documents, requests under the Freedom of Information Act (FOIA) and Google search with predefined terms. In the case of the UK, we found 378 contracts in the manually collected data.

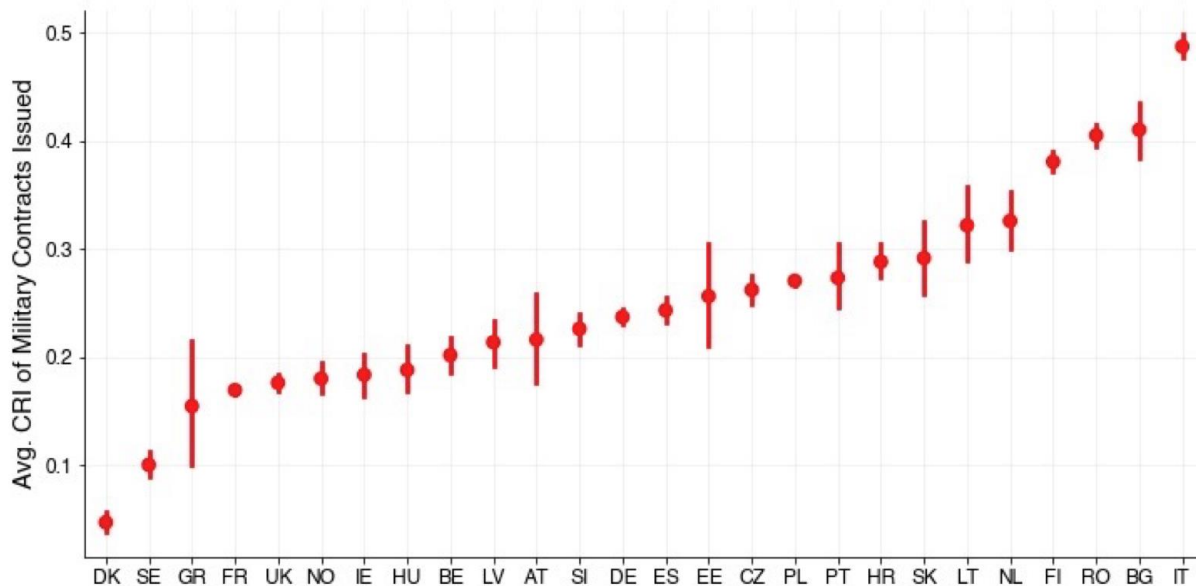
Each contract from the TED database has been assigned a corruption risk index (CRI), which is a composite index based on 6 red flags: single bidding, procedure type, length of advertisement period, evaluation criteria, call for tender publication, and the length of decision period. The resulting CRI is based on the count of red flags in each contract divided by 6 (Fazekas, Tóth, and King, 2016). Overall, the dataset, based on TED data, contains 1459 defence procurement contracts in the UK between 2006-2016.



Second, the analysis relies on qualitative sources, that include semi-structured interviews with key defence procurement experts and actors involved in defence procurement process, supplemented with secondary sources, including press materials, government and audit institutions’ reports and various policy documents.

Compared to other EU member states, the UK is among countries with the lowest CRI, being behind only 4 countries, as shown in Figure 4. If we compare the UK’s military corruption risk score, with the one for public procurement in general, we can observe, that as in most countries, military corruption risk score is slightly higher.

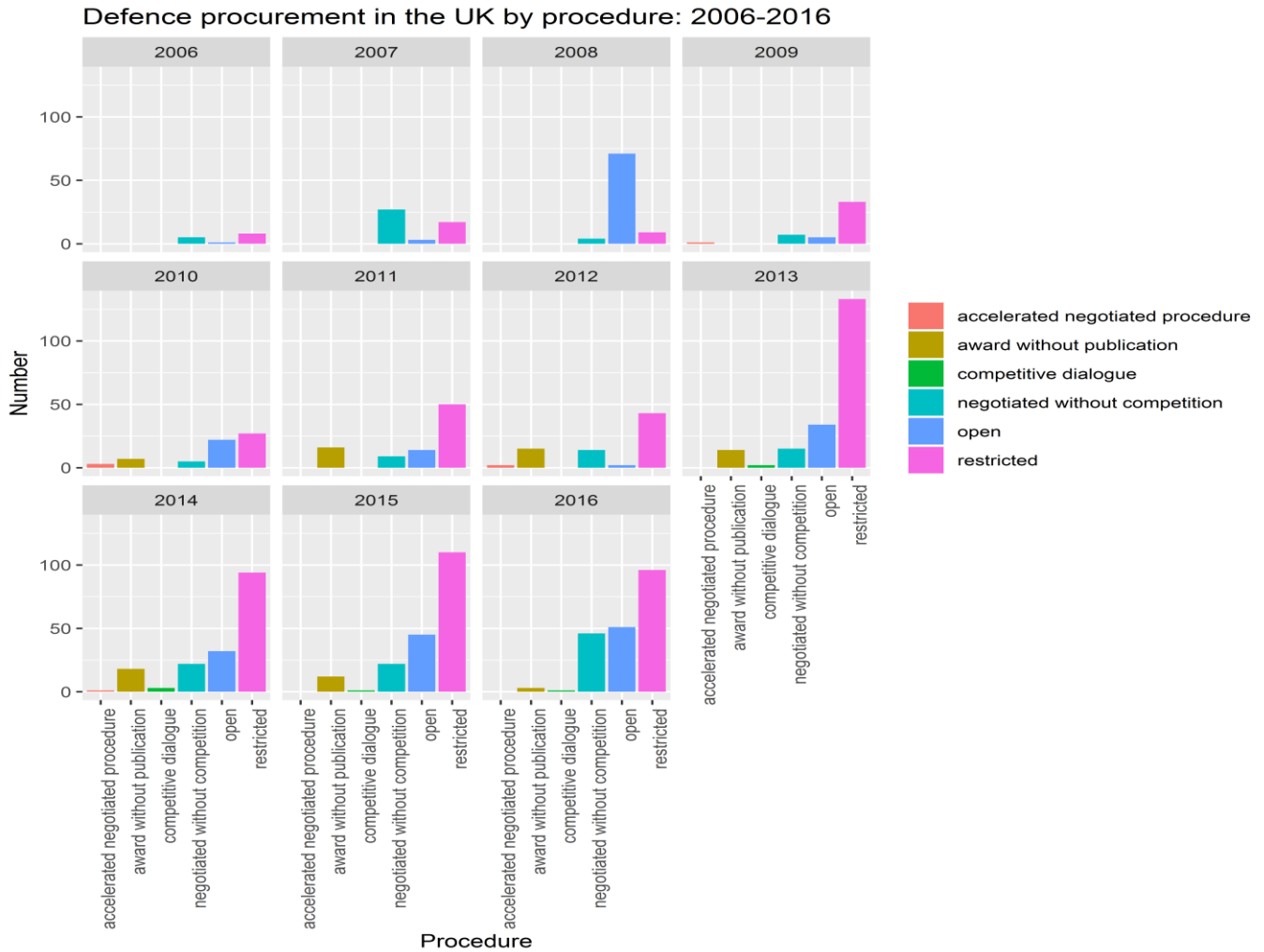
FIGURE 4. AVERAGE CRI FOR EACH COUNTRY, BASED ON TED DATA BETWEEN 2006-2016. SOURCE: GOVERNMENT TRANSPARENCY INSTITUTE.



However, once we dive deeper and observe the within case level of the UK, we can see a variation in the CRI. Namely, the CRI spans from 0 to 0.75, with median value being 0.17. First, let us look at the distribution of procedure types over years in the UK, which is one of the criteria of our composite CRI. We can observe in Figure 5 that the number of contracts with restricted procedure started to increase in 2009 and was the highest in 2013 with around 130 contracts.



FIGURE 5. THE DISTRIBUTION OF CONTRACTS BASED ON PROCEDURE TYPE BETWEEN 2006-2016. IT INCLUDES 1175 OBSERVATIONS, BASED ON TED DATA. 284 OBSERVATIONS WERE EXCLUDED DUE TO MISSINGNESS.



Next, let us observe the network visualization of the UK’s defence procurement market. Figure 6 shows a two-mode network connecting buyers and winners if there is a contract relationship between them. Buyers are colored black and winners yellow, while the edges are colored purple in case their CRI is higher than 0.5. There are several important points to make about this network. First, there are only 8.69% of contracts that have CRI higher than 0.5, which suggests, in line with the cross-country findings, that the UK has low levels of corruption risks. Second, if we look at the distribution of purple edges, we can see that corruption risks are more prevalent in certain parts of the network: they tend to be clustered and centralized. Now, let us look closer at the main issuers and winners based on the CRI score.



FIGURE 6. THE NETWORK CONNECTING ISSUERS (BLACK) AND WINNERS (YELLOW) OF DEFENCE PROCUREMENT CONTRACTS IN THE UK BETWEEN 2006-2016, BASED ON TED DATA. THE ISSUERS AND WINNERS ARE CONNECTED IN CASE OF CONTRACTING RELATIONSHIP. EDGES ARE COLORED PURPLE IF THEIR CRI IS HIGHER THAN 0.5.

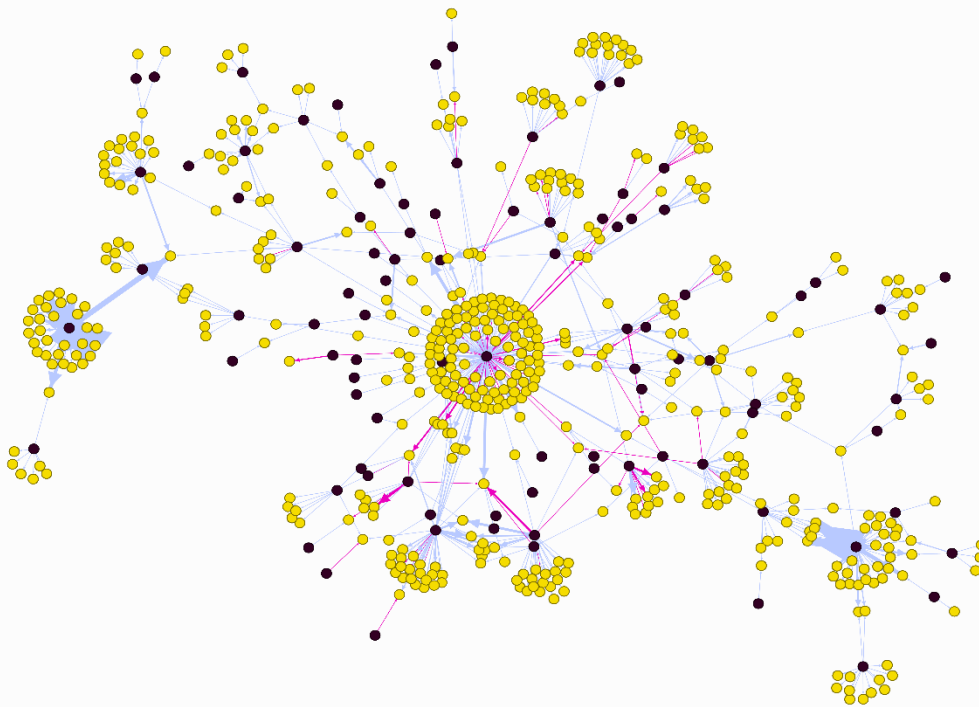




TABLE 1. WINNERS AND ISSUERS WITH THE HIGHEST NUMBER OF CONTRACTS WITHIN HIGH AND LOW CRI THRESHOLDS.

Winners		Issuers	
High CRI (>.6) + the highest number of contracts received 37 observations	Low CRI (< .25) + the highest number of contracts received 1178 observations	High CRI (>.6) + the highest number of contracts issued 37 observations	Low CRI (<.25) + the highest number of contracts issued 1178 observations
BAE Systems (Operations) Ltd	Parsons Brinckerhoff Ltd	Aircraft Support As DES	Argyll and Bute Council
Rolls Royce Plc	Ch2m Hill United Kingdom	Defence Support Group	Leeds City Council
Bae Systems Global Combat Systems Limited	Mott Macdonald Limited	Ministry of Defence Land Equipment	Ministry of Defence Land Equipment
Van Halteren Metaal Bv	Hunter Apparel Solutions Ltd	Combat Tracks Group Systems Team DES	Yorkshire Purchasing Organisation
Ultra Electronics Limited	Lion Apparel Systems Limited	Ministry of Defence DSTL	Transport for London

Table 1 shows issuers and winners with the highest number of contracts, classified based on their CRI, from TED data. I set the threshold for high corruption risks to be above 0.6 to capture the issuers and bidders that are in the highest category of corruption risks in the UK. On the supply side, the first important thing to notice is that the high and low risk thresholds clearly separate prime contractors from smaller companies. Namely, some of the biggest defence contractors, with the highest market share of defence procurement contracts in the UK are in the high corruption risk category: BAE and Rolls Royce. Considering that both firms have comparatively high percentages of non-competitive contracts, part of the reason for being in this category is inherent to the nature of the defence sector. Namely, there might be contracts for which only one company is eligible to participate due to different reasons, outlined earlier (e.g. security reasons, intellectual property rights). Nevertheless, single sourced procurement contracts have some obvious risks, that will be discussed further in the next sections.

The contracts in the low corruption risk group are either service or supplies type, and all of them are procured through competitive process. Firms in this group do not belong to prime contractors, and their contracts are comparatively lower in value. For example, based on the recent MoD data, BAE Systems Marine Ltd is in the group of contractors that received more than £500 million from MoD core department, UK Hydrographic Office and Defence Science and Technology Laboratory in 2017/18, while Mott Macdonald Ltd is in the group that received between £10-25 million (MoD, 2018a).

On the issuing side, the single biggest issuer in both high and low CRI contracts is the MoD. In the next sections, I will focus on this issuer the most, considering that the MoD is not only the biggest issuer, but



is the issuer of the largest value contracts and the most single sourced contracts. Among low CRI issuers, we see regional and local level organisations, such as Leeds City Council and Yorkshire Purchasing Organisation. Some of these issuers do not exist anymore, such as the Defence and Support Group. This was the trading fund of the MoD established in 2008. Parts of it were sold to Babcock International in 2015, and the rest became the Defence Electronic and Components Agency.

To sum up, the above data suggest several important conclusions. First, there is a clear distinction between prime contractors and smaller companies, mostly in the service sector in terms of their CRI. Second, issuers with the low level of CRI are typically regional and local level organisations, while the MoD comes out as the most prominent procurer in both high and low CRI groups. Third, some of these differences can be explained by characteristics of the defence market as such. Namely, single sourced procurement contracts are more likely in tenders that involve big prime contractors, because these contracts tend to be the most complex, and most likely to be procured under non-competitive procedures, due to different reasons, such as security or preserving freedom of action of the government. However, aside of reasons inherent to the defence sector, there are obvious corruption and state capture risks that do occur in single-sourced contracts. Thus, the remainder of this report will focus on most pressing corruption and state capture risks in the defence acquisition process in the UK, informed by the analysis in this and in previous sections.

6. Corruption and state capture risks in defence procurement in the UK

In the remainder of this report, I address the main corruption and state capture risks in the UK defence procurement process, relying on semi-structured elite and expert interviews with key defence procurement experts and actors involved in defence procurement process, media sources, and policy reports. The analysis in this section builds on a) the contextual background of the UK's legal and institutional framework around defence acquisition process and b) the results of data analysis of corruption and state capture risks in defence procurement in the UK between 2006-2016.

The first subsection addresses the issue of the revolving door. It first defines and discusses the phenomenon of the revolving door. Second, it shows how relevant the revolving door problem is in the UK defence sector, relying on official government and auditing institutions' reports and press sources. Third, it explains how the revolving door influences defence companies in the procurement process. The subsection on the revolving door discusses the issue of administrative inertia, which explains to what extent long term ties between the government and defence contractors inhibit competition and affect achieving of the better value for money (VFM). Finally, I discuss potential solutions that can contribute to minimizing the corruption and state capture risks of the revolving door while recognizing their value in enhancing cooperation between government and industry.

Subsection 6.2 looks at how some deceptive techniques in the bidding stage can influence defence procurement outcomes, such as cost overruns, and to what extent they are present in the UK context. Subsection 6.3 looks at the post-award performance and analyzes how political interference, relational



ties between government and industry and poor project monitoring influence cost overruns, delays and cancellations of defence procurement contracts. I demonstrate how both political and business actors contribute to problems in the post-award stage. Finally, I address the issue of offsets, by observing their relevance in the UK, especially considering recent changes in the budget allocation for the defence acquisition process.

6.1 Benefits and risks of the revolving door in defence procurement in the UK

The revolving door refers to movements of individuals between positions in public office and private or voluntary jobs, and vice versa (David Barrett, 2014). The movements from public to private sector in the UK are monitored by the Advisory Committee on Business Appointments (ACOBA), a non-departmental public body that provides advice about business appointments of former ministers and senior civil servants, but not MPs, two years after they leave public office. The body assesses each case individually and gives recommendations to the Prime Minister. As it is not a statutory body, ACOBA is often criticized as being “toothless” and for lacking the ability to enforce its decisions (Dunton, 2018).

Some arguments point in the direction of beneficial effects of these movements, in terms of improving the communication and cooperation between the public and the private sector (Interview 4). However, the revolving door carries obvious corruption and state capture risks, that typically include: a) abuse of office by giving preferential treatment to certain companies in expectation of future employment, b) undue influence in contractual negotiations by using previously acquired contacts or commercially sensitive information, and c) undue influence in public policy making (David Barrett, 2014; Willks, 2013). As one former RAF officer with private sector experience explained in the interview, companies want individuals who have been in government for two reasons: for their contacts and their insights (Interview 1).

The danger of revolving door in the UK was exemplified in the documentary “Politicians for hire”, broadcasted in 2010 on Channel 4, which showed recordings of MPs and former ministers offering their services, influence and contacts to undercover journalists who were pretending to be a corporate employer (David Barrett, 2014; Willks, 2013). One of them, Geoff Hoon, Labour politician and a former Defence Secretary, based on conclusions of Standards committee, was offering to undercover journalists to brief them about Strategic Defence Review, based on confidential briefing that he got from MoD officials, and in this way, he violated the Code of Conduct (Willks, 2013, p. 22; CSP, 2010, p. 18).

The evidence suggests that revolving door are a common practice in the UK. Namely, between 2000-2014, 600 former ministers and top-level civil servants were appointed to 1000 various private sector roles, based on ACOBA reports (Willks, 2013). The statistics also reveals that most former ministers and officials moved to advisory and consultancy positions (Willks, 2013). The revolving door is disproportionately present in the defence and health sectors. The defence sector is especially sensitive because the government (MoD) is the main buyer of the military equipment. As Willks notices, there is a huge movement of former MoD officials after retirement into the private sector, which is worrying if these people were involved in the contract negotiations, while in public office (Willks, 2013, p. 20). Based on ACOBA reports, movements from the Cabinet Office and Ministry of Defence had the largest number



of applications in 2016-17 and 2017-18 (ACOPA, 2018, p. 6). Some prominent examples in the defence sector include the appointment of the former Tony Blair's Security Adviser David Omand and Lieutenant-General Sir Paul Newton to Babcock; Air Chief Marshal Sir Simon Bryant was hired as a Programme Director at BAE Systems in 2012, while the former British Ambassador to Saudi Arabia, Sir Sherard Cowper-Coles became its Business Development Director in 2011 (Brooks & Hughes, 2016).

The opposite movement, from private to public sector, also happens in the UK. Namely, Guardian reported that dozens of employees of arms contractors were seconded to positions at the MoD and other government posts. More than 10 employees of BAE were seconded into the MoD in 2014, and some opposition politicians at the time warned about the cozy relationship between the MoD and the industry (Quinn, February 2015). The dangers of revolving door for corruption can be illustrated with the Case study 1 below regarding the privatization of search and rescue helicopters.

Case study 1. The privatization of search and rescue helicopters worth £6 billion was cancelled in 2011 after suspicion was raised that the former staff of MoD misused commercially sensitive information (David Barrett, 2014). The then Transport secretary Phillip Hammond stated that the government had information on irregularities, and decided to terminate talks with the Soteria consortium, comprising of CHC, Thales UK and Sikorsky, which was selected as a preferred bidder (Barker, 2011). According to press sources, members of the rival consortium complained back in 2008 after discovering that some military officers involved in privatization went to work for CHC.

The issue of revolving door is important in the UK, considering: a) the extent of movements from government to industry, as discussed above and b) the evidence from our fieldwork research suggesting that the defence procurement has been conversational in the past. As one procurement expert, formerly employed by one of the prime defence contractors explained:

It's always good to have face to face [encounters]. Every contractor that wants to do business with the government needs to be in London and probably needs to be in Bristol, because Bristol is where the large procurement agency office is. If they want to increase their chances of doing business and talking, then they need to have someone who is next door to the procurement agency. (Interview 4)

This suggests that the revolving door is especially relevant in the context of defence procurement in the UK. So, how does the revolving door function in practice in the UK? Namely, what can a contractor gain by hiring a former minister or a top-level civil servant? Understanding the requirements better was a frequent answer in the interviews. Namely, one former top-level MoD official who moved to private sector after retiring said that benefit of these movements is that:

The industry is not guessing what the requirements are. Because quite often, they may design something which is not going to be easily usable at the Front Line. So, bringing that experience into industry I think is good, whereas it's not so good when they simply use it as access between the company and procurement designers. (Interview 5)



The requirements and evaluation criteria are sometimes hard to interpret, and companies often need someone helping them to understand what a particular evaluation criterion really means. As one procurement expert from the industry explained, having a conversation with people you are selling to helps, because you need an explanation of requirements. Moreover, he emphasized that:

It is about relationship management and insights about what the command structures at MoD and RAF are saying. Having someone who is able to say hello to the Head of Command because they had a past relationship and then listen and hear what happens is great. But at the end, the selection process will be what it is because it has been defined by the commercial team. (Interview 4)

As some of my interviewees point out, it is not only about requirements, but what lies behind them and how should companies target their future research development towards the merchant needs (Interview 3). Although having these connections does not indicate a corrupt relationship, it can obviously put a company in a strong position, because these ties help companies in understanding the requirements better and perhaps the future strategic orientation of the government. These connections have a time limit, however. Namely, the contact list of a former civil servant remains fresh for a limited amount of time, but, based on my interviews, not for more than a year or two. As one defence audit expert explained:

Industry wants these people because they have insights into how Department works. They'll know the personalities involved on the other side of the fence. So maybe they [can] say: 'Oh this is a good way of approaching these people'. (Interview 2)

Considering that the defence market in general, and in the UK in particular is dominated by a small number of prime contractors, there are inevitably some long standing ties that have been established over years. These long-standing ties, in combination with a rather advisory position of ACOBA, do create a danger, if not of corruption, than to a very least of certain administrative inertia, as we will see below. The current system of regulating revolving door has some obvious problems. The most obvious problem is the lack of full transparency in these movements and the fact that, for example, temporary workers and consultants do not fall under the ACOBA rules (House of Commons, 2017, p. 23). As one interviewee pointed out:

I think our system at the moment is not as good as it should be. The other way of doing it is, rather than trying to close the loopholes, actually to actively encourage it, but make sure there is clarity about bias in the procurement decision making. If you've already got a program with a company x, it helps to have good liaison between military and company x. (Interview 5)

6.1.1 Administrative inertia

In the defence market, characterized by a small number of prime contractors and one major buyer, there is a risk of a certain inertia in the relationship between requesters, delivery organization and the industry. These kinds of relationships may also influence the outcome of the procurement process. As one defence audit expert explained:



There are probably some long standing relationships at the organizational and at the personal level in procurement, because a lot of procurement professionals in the Department have been there for a long time. Because inevitably, it's just habit, you get used to them [contractors], and they may be your friend, and so on. Not in the corrupt way necessarily, but just too comfortable, too cozy, not pushing them hard enough as a result. (Interview 2)

Risk aversion also tends to play an important role, because due to high value contracts and budgetary constraints, governments tend to be risk averse. As defence audit expert explained, they would prefer to do anything to avoid risk, including procuring the same or similar products and services that they procured in the past and dealing with the same people and contractors as they are used to (Interview 2). Namely, as Transparency International notices in its report on defence procurement, one risk is that requirements could be guided by what they used in the past, in a way that historical ties with contractors can inhibit transparency of the procurement process (Transparency International, 2004).

Consequently, the full transparency of the movements between MoD and defence contractors is necessary. Currently, there are certain loopholes in the process that inhibit this transparency, such as hiding behind consultancy mask while lobbying for the industry, shortly after leaving the MoD. Moreover, the position of ACOBA is not as strong as it could be in monitoring these transitions. As some of my interviewees noted, the revolving door can help in improving the communication between requesters and suppliers. However, considering the narrow nature of the defence market, the revolving door can further lock certain companies into advantageous positions and contribute to inertia in the relationship between the MoD and industry. These are important risks, because, as we will see in more detail below, the MoD had troubles in the past in achieving VFM: there were cost overruns, delays in project implementation and cancellations of projects.

6.1.2 The main challenges of the revolving door in the UK

The revolving door is a common practice in the UK's defence sector. The analysis in the previous two sections suggests two main conclusions: a) In the context of the UK defence procurement process, which is characterized by having complex projects that involve a lot of research and development (R&D), the movements between government and industry are essential for improving communication and cooperation on demanding projects and b) the revolving door carries obvious corruption and state capture risks, if it is used as an access point for companies to get either preferential treatment by the government or an easy access to commercially sensitive information, which can distort the competition and results in failures to achieve the best VFM. Considering these two conclusions, the question is what can be done to control the revolving door in a way to minimize the risks of corruption and state capture that may occur when these ties are merely used as an access point while preserving their benefits, with regards to communication between government and industry. Policy recommendations at the end of this report suggest potential solutions to this challenge.



6.2 Defence procurement in the UK: corruption risks in the bidding process

Corruption can occur in various stages of procurement process, as the literature suggests (OECD, 2016; Flyvbjerg & Molloy, 2011). It can come in form of deception of suppliers by misrepresentation of costs, in expectations of increasing the price in the post-award phase, as low bidding to increase the chance of winning a tender or as some form of political interference. Defence has certain characteristics that make corruption risks even bigger, as discussed earlier. Our data show that corruption risks tend to be clustered around MoD as the single biggest buyer in the defence market in the UK, and around some of the top prime contractors on the supply side.

Defence acquisition process in the UK has suffered in the past from failures to achieve VFM, due to contract delays and cancellations and significant cost overruns. Some of these issues are inherent to the nature of the defence sector and its market, such as the high technology equipment and a lot of research and development (R&D) projects, that make cost assessment a challenging task, but some others can point in the direction of corruptive activities. As reported by Guardian, MoD has made 44 allegations of corruption and bribery in defence contracts since 2011, of which 29 were related to UK firms (Press Association, 2016). However, as none of these companies were found guilty, the MoD has not excluded any of them from bidding on tenders (Press Association, 2016).

Low bidding in competitive tenders is one typical technique for increasing chances of getting a contract. As one procurement expert formerly employed by one of the UK's prime contractors explained:

I am very aware that there are competitors that always bid low price on basis that they could amend. The contract amendments is where they made their profit. Because they would bid low and say: 'Ok you got that, but you need all these extra bits.' The art of doing that was about how you write bid documents. Whilst we threw everything in and bid everything we believed was needed as an answer to the question, our competitor would bid the minimum answer: define what the minimum was and put everything else that you could have if you pay extra. (Interview 4)

The additional problem in the post-award period is in attempts of contractors to push the price up by initiating renegotiation. As one public sector procurement expert explained, it happens that companies try to make more profit, by selling more bits into contract or by changing the margins (Interview 6). Certain inertia is also present, and it reflects the trade off between risk and stability. Namely, as one procurement expert explained:

We see maybe in buying consultants, they know that they want that particular consultant to come and work on that particular piece of work, so they just try to find a way of getting them, because, for couple of reasons really: one is that they know their skills, and the other is they need it quickly. Again, both of those are poor procurement generally. (Interview 6)

There is a certain level of favoritism present, based on my interviewee (Interview 6). These are more common at the local level, rather than in big contracts. Some of our corruption risk indicators, such as single bidding, can occur as a consequence of the market characteristics of the defence sector. Namely, single sourced contracts are inevitable in cases when only one contractor is capable of delivering the



product. Considering that these contracts account for half of all defence procurements in the UK, the attempts were made to improve the scrutiny of these contracts, by introducing SSRO, as discussed earlier. Nevertheless, single sourced contracts carry some corruption risks, even though the UK introduced the new SSRO regime with an aim to improve their scrutiny. As Georgopolous (2016) argues, even the highly scrutinized single sourced procurement is only second best to competitive tendering, and he thus suggests a closer scrutiny of the initial decision to choose single sourcing over competitive tendering in the UK.

6.3 Post-award monitoring and cost transparency

Large defence contracts tend to have long and deep supply chains, which makes monitoring in the post-award phase a challenging task. The evidence in the UK suggests that problems that arise in the post-award phase, such as cost overruns and delays in contract implementation have their sources both on the requester and on the delivery side. Some of the risks are inherent to the nature of defence contracts. For example, in research and development projects (R&D), where requester wants to have something innovative built from scratch (e.g. a nuclear submarine), the delays and cost overruns are likely to occur. Some of the issues have been recognized by the MoD in their reports, such as a) the unstable interface between the requester within the MoD and the deliverers in the Defence Equipment and Support (DE&S), b) poor specification by the requester, c) poor initial cost estimation and d) poor project control by the DE&S (MoD, 2013).

As one procurement expert from the public sector explained, the specification is the key, and having a good contract management team capable of managing the contract, who work closely with the supplier and understand the risks all the way down the supply chain (Interview 6). The MoD in the past has struggled and has often failed to achieve VFM in defence procurement contracts, which motivated several reports aimed to improve the situation, as discussed in previous sections. As one defence audit expert explained:

Contractor performance, as we reported frequently in the past has historically been very poor both with BAE, the part of Rolls Royce that builds nuclear reactors. Things go over by years, they go over by costs, hundreds of millions of pounds. (Interview 2)

SSRO's reports support this view. Namely, SSRO in its report in 2016 challenged £61 million of potentially non-allowable costs in single sourced contracts (Hollinger, 2016). Not surprisingly, the new SSRO regime did cause objections from the industry, and this partly draws on the issue of cozy relationship between the government and the industry without enough scrutiny. As one defence audit expert explained:

There was a lot of opposition to this from contractors to start with, for obvious reasons, but also beside obvious reasons: 'We don't want you to know we are making a lot of money, we are charging profit on you down here, and then we are charging more profit at the top.' Part of the problem of some even quite big contractors was that they didn't understand their own cost enough, to be able to produce this kind of costing statement. I think partly because in the past they just said: 'All right, it's time to produce another one of these. Well, this is what we charged



you the last time, we charge you a little bit more this time and our profit on the top.’ A lot of contractors have had to understand their cost base a lot more, as part of these regulations. (Interview 2)

The evidence suggests that issues occur on both sides, and that political interference and budgetary constraints sometimes induce additional costs in defence procurement contracts. As one former top-level MoD officer explained on the example of the carrier project: The Secretary of State for Defence at the time, decided to change parts of the design, which added £500 million to the program (Interview 5). Some issues related to political interference are present at the local level in the UK as well, as a way of supporting local businesses and reviving industry. Hence, there are attempts at the local council level to support local businesses. Considering the EU compliant procurement regulations, this is often done by reaching out to businesses at the local level, and empowering them, by supporting them in learning how to bid and to make sure they are aware of opportunities, rather than just giving them contracts (Interview 6).

Case study 2 illustrates the general findings of the interviews, that suggest that delays and other problems in the post-award phase of contract implementation are a combination of several factors and that both requesters and suppliers can be responsible for the issues that arise. Namely, as the case of the contract for recruitment of new soldiers into the British Army with Capita suggest, the MoD failed to deliver all the necessary infrastructure, while Capita under-estimated the complexity of the requirements for the new online system (NAO, 2018).

Case study 2. Capita Business Services Ltd (Capita) got a 10-year contract in 2012 to recruit new soldiers into the British army. The report of NAO of 2018 documented that Capita missed its recruitment targets by an average of 30 percent since 2013 (NAO, 2018). Before the Defence Committee, General Nick Carter stated that he thinks that Capita’s bid was overly ambitious. He also emphasized that requirements were too complicated, with 10,000 sub specifications in the tender (Owen, 2018). However, the report of Public Accounts Committee (PAC) pointed out problems in the MoD, considering that they “signed the contract with Capita before taking the decision to increase the size of the Army Reserve, passed the firm details of 12,000 potential candidates rather than the 55,000 the company had been led to expect, and did not provide the IT infrastructure needed to deliver the contract” (Green, 2014). Speaking before PAC, chief executive of Capita Johnathan Lewis admitted that previous leadership of the company was more concerned with revenues than with setting realistic recruitment targets (Bond, 2019).

6.4 The risks of offset practices in the UK

Offsets refer to practices of governments in defence procurement aimed at securing certain return on investment for their domestic industry after awarding a contract to foreign contractor. The most typical



manifestation of offsets is a commitment of a foreign contractor to involve domestic industry in the contract implementation, for example through subcontracting (Georgopoulos, 2011). Based on the Code of Conduct on Offsets⁸, the offsets should be used for developing industrial capabilities⁹ and if used as a criterion for tenderer selection, their weight should be less significant. As one legal expert explains, prime contractors do not like offsets because:

They feel that offsets, if they are legalized, they provide the comparative advantage to non-European companies. Particularly American companies, because they are in the better position, because of the size of their national markets to comply with requirements of offsets and perhaps provide overall more competitive packages. (Interview 7)

Moreover, the UK, having prime contractors, is able to sustain national industrial base in other ways rather than using offsets. As a legal expert explains:

They don't need to put subcontracting obligations, at least for some of the contracts, right? They simply say, these procurement opportunities are to be procured competitively, some others will go down the road of sole sourcing. Why? Because of security reasons. There you have the allocation to your national primes, and, of course, maybe an understanding with the company, with the MoD or the contracting authority, that involves certain subcontracting opportunities, or spreading implementation across the country. (Interview 7)

However, certain structural reconfiguration in terms of budget allocation at the MoD might have contributed to an increase in purchases abroad, as discussed earlier. Some evidence suggests that these transformations somewhat affected the selection of contractors in defence procurement process. Namely, as one defence audit expert explains:

Once the money went into commands and they got the budgets, my reading on this is that they got the money, they are very impatient to actually get the equipment. They are fed up of working with these contractors, to develop something from scratch, and it takes 15 to 20 years, it costs far more than it should, and at the end of it they still don't really get what they wanted in the first place. Their response to that is well, look, the Americans have got one, they got one in service already, we have to be interoperable with it because it's NATO, so why not just buy some of those. And they will throw in foreign military sale, they will throw in the training. (Interview 2)

He further argues that we can see in some recent sales that in a lot of very large British contracts which have been announced recently they are increasingly going abroad, going to American contractors in particular, buying stuff as a foreign ministry sale through the US government (Interview 2).

For example, as he argues:

There is a bit of quid pro quo here. What they tend to do is that they get the contractor to agree to do something in Britain to sugar the pill, so with the P8 Poseidon they are setting up northern European maintenance harbor in Scotland. Norwegians will use that, Americans will use that, that creates some jobs... They always announce that it's great, it's never said publicly that that

⁸ It is a voluntary and non-binding code that formally came into effect on July 1, 2009, and launched by European Defence Agency, with an aim to introduce transparency in offset agreements.

⁹ More details: <https://www.infodefensa.com/wp-content/uploads/TheCodeofConductonOffsets%5b1%5d.pdf>.



was a deal breaker. I suspect we would still buy these things anyway, but it's obviously nice, because there are MPs with constituency interests where these places are located. (Interview 2)

To sum up, offsets are not the major issue in the UK, because having big prime contractors and a possibility of going single sourced, there is no need to a lot of offset arrangements. However, some recent reforms in terms of budget allocation might contribute to an increase of these arrangements, considering an increase in the number of foreign purchases.

7. Discussion and conclusions

In this paper, I have analyzed the major corruption and state capture risks in the defence acquisition process in the UK, relying on quantitative and qualitative data.

The paper first, addresses relevant literature on the main corruption and state capture risks that may arise in the defence procurement process. The literature recognizes that some problems of defence procurement, such as cost overruns and lack of competition, can be a consequence of features which are inherent to the defence sector, that relate to market structure and complexity of projects. Some of these problems may arise, however, because of relational ties between government and industry which are formed through the revolving door. Contractors can use these ties to secure preferential treatment or access to commercially sensitive information. These risks are especially relevant in the context of the UK, considering that around 50% of its defence contracts are non-competitive.

In section 3, I explain the evolution of institutional reforms relevant for defence procurement and point out the most pressing risks in the current institutional framework in the UK, focusing on the challenges in achieving VFM and improving control of non-competitive contracts. I discuss the transition from the voluntary Yellow book approach to a statutory framework for single-sourced procurement established under the Defence Reform Act of 2014. The section demonstrates that a combination of factors has led to failures to achieve better VFM in the past, which include: problems in project management, contractor performance and the lack of understanding of cost drivers. Despite attempts to improve the scrutiny of single-sourced contracts, the important challenges remain, considering that large portion of single-sourced contracts remains beyond the scope of SSRO.

In the empirical part of the report, I first discuss (Section 4) the market landscape with respect to both buyers and suppliers. I explain the evolution in the market consolidation on the supply side and offer data on the share of single sourced contracts for big prime contractors. In Section 5, I analyze the case of the UK, based on our contract data collected from TED. The data analysis in this section offers five important findings: a) Compared with other EU member states, the UK is among countries with the lowest CRI, b) the network analysis based on contracting relationship between issuers and winners of contracts suggests that corruption risks are clustered and centralized, c) big prime contractors have the most contracts in the group of high CRI, d) the MoD appears in the largest number of contracts with both high and low CRI, e) regional and local level organisations, such as Yorkshire Purchasing Organisation are in the group of issuers with the highest number of low CRI contracts.



In section 6, I rely on semi-structured interviews with key experts in defence procurement and actors involved in defence acquisition process to analyze the most pressing corruption and state capture risks in the UK. I find that the most central risks relate to a) the revolving door - the movement of individuals between public and private sector positions, b) the control of non-competitive procurement contracts and c) post-award contract performance, with regards to monitoring, contract delays and cost overruns. The biggest risks that emerge from the revolving door are in enabling companies to get preferential treatment and easy access to decision makers in the defence procurement process. Considering that the defence market is dominated by a few large contractors, these ties can further lock companies into advantageous positions, at the expense of competition and of achieving better VFM in defence contracts.

Regarding post-award performance, the analysis demonstrates that problems occur on both the issuer and contractor side. Namely, poor project control and occasional political interference can induce large additional costs, which then result in poor project performance, delays and even cancellations. On the other side, contractors, especially those that have a strong market power and are awarded single-sourced contracts, were characterized with poor performance in the past. The effects of recent changes in the control of single-sourced contracts are still to be fully seen, but SSRO already took an initiative in its reports to stress some pressing issues, such as non-allowable costs in defence procurement contracts.

8. Policy recommendations

8.1 Develop a database to assess the effects of the revolving door on defence procurement

Considering that the findings in this paper suggest that the revolving door has both benefits - with regards to improving the communication between government and industry on complex projects, and that it carries corruption and state capture risks - when the purpose of these networks is to serve as an access point for companies to get preferential treatment, the goal is to suggest policies that would preserve the beneficial effects of the revolving door, while minimizing its risks. Currently, ACOBA, which records and advises on the movements of public officeholders to the private sector, publishes the appointments taken by former Crown servants and former ministers on its website. However, the ACOBA does not have neither enough resources nor an appropriate data to assess the risks of these appointments. Aside of media sources, we do not have a systematic data on the effects of the revolving door on defence procurement. Thus, the UK would benefit from developing a database on the extent of the revolving door and their effects. This database would be in the form of a network, that would connect a defence contract issuer and a defence contractor if they are connected with both contracting relationship and an individual that was previously employed in the public sector. The database would contain the information on:



- the position in the company that individual who has been previously employed in the public sector has,
- the position that said individual had while in the public sector,
- the value of the contract, its starting year, and the description of the project
- the procurement procedure type,
- Corruption Risk Index (CRI) could be assigned to each contracting relationship,
- the performance of the contract in the post-award phase, with regards to cost overruns, contract delays or possible cancelations.

This database would be published and regularly updated on the ACOBA webpage. Having this data, that are currently scattered in reports of various institutions (MoD, NAO, ACOBA, Defence Select Committee, think tanks), in one place, would enable a clear understanding of a) the extent of the revolving door in the defence acquisition process, and more importantly b) the performance of contracts awarded to firms that hire individuals previously employed by public sector. Consequently, this database could be used to suggest more specific policies for regulating the revolving door in the UK.

8.2 Reintroduce the responsibility of ACOBA to monitor the revolving door beyond the Director General level

Junior level individuals are also involved in the contract negotiation process and may have access to commercially sensitive information. Considering that the extent of movements from the public to the private sector has increased in the last decade (House of Commons, 2017), and that movements happen in the junior level as well (due to more attractive compensation packages in the private sector), it is desirable to expand the monitoring to those individuals below the Director General level as well.

8.3 Improve the quality of justifications for choosing a non-competitive defence procurement process

Although the UK has made a progress in scrutinizing single-sourced contracts, by establishing SSRO in 2014 under the Defence Reform Act, the initial decision for choosing non-competitive tendering rather than competition needs further improvements. Namely, the reports of NAO and legal experts' views suggest that the justification for going single-sourced by project teams vary in quality (2017; Georgopolous, 2018). Considering that single-sourced procurement contracts account for around 50% percent of defence contracts let in the UK, it is necessary to thoroughly evaluate, assess and explain the benefits and reasons for choosing single sourced tenders rather than competitive ones. This is especially important if we consider that the UK had and still has troubles in achieving best VFM in its defence procurement contracts. Namely, the findings in this paper suggest that there are cost overruns, contract delays and occasional political interference in large defence contracts. Thus, it is crucial that



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the MoD carefully assesses the benefits of going single-sourced. These justifications should be made publicly available.



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