



CENTAR ZA MIROVNE STUDIJE

The transparency of public procurement in the defence sector of the Republic of Croatia

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I Introduction

On July 1, 2013 the Republic of Croatia became a full member of the European Union. The twenty-two-year-long path from its declaration of independence to its full membership in the EU was marked with numerous political, institutional and social reforms. The reforms were not only the result of Croatia joining the EU, but also of joining the NATO, whose member Croatia became in April 2009. The significant international monitoring under which Croatia has been in the last few years has greatly contributed to the country's democratization. Of course, entering international organizations such as the EU and the NATO in no way means the process of democratization is completed. On the contrary, many authors point out that after a country enters the EU and the heightened international monitoring ceases, the quality of democracy can deteriorate since the feasibility of many reforms can come into question.

Croatia still faces many challenges. One of them is certainly the fight against corruption. Croatia has taken admirable steps in creating the legal and institutional framework and in raising the level of political culture in condemning corruption. These processes have resulted in concrete indictments against high-positioned politicians, accused of, and in some cases convicted for, corrupt practices. The domain of public procurement is one of the areas which are most vulnerable to corruption. Therefore, this area has undergone numerous legal and institutional reforms on the state level. This paper will focus on the transparency of public procurement in the Ministry of Defence of the Republic of Croatia.

1.1. Reform of the state security sector

In this paper, the umbrella term “security sector” refers to the three sectors traditionally understood under this term: the police, the military and the security services. Each sector is accompanied by several institutions responsible for the supervision, execution and coordination of its work. These institutions have undergone numerous reforms which have reformed their war-time *modus operandi* into the post-war *modus operandi*. It is important to point out that the Croatian Army, for example, enjoys significant support from the public compared to other institutions of the state. According to research, about 40% of Croatian citizens show a high level of trust towards the military, one of the reasons being its role in the war, showing it to be the key component in Croatia's attainment of sovereignty and independence. Such pronounced and widespread positive opinion about the military has resulted in a lack of critical attitude not only toward the military's role in the war conflict, but also toward the procedures and affairs within the military, including the emergence of corruption in the defence sector.

An important step forward in the democratization of the armed forces took place in 2001 when former Croatian president Stjepan Mesić retired seven generals of the Croatian Army due to their political engagement. The depoliticization of the military was the first post-war challenge in the reform of the defence sector.

After the retirement of the generals there followed a series of legal changes which permanently enabled a depoliticized system of defence. After the process of depoliticization was more or less concluded, the question of the transparency of the defence sector budget spending and the issues of adequate supervision were opened. Of course, what constantly needs to be kept

in mind here is the parallel process of the reduction of the number of active soldiers and of the officials of the Ministry of Defence. The management of human resources and their reduction, as well as the adjustment to peacetime conditions, was a very important step in the democratization of the defence sector. The question of transparency was somewhat spectacularly reopened by former president Stjepan Mesić when he expressed his suspicions about the process of public procurement of military trucks in 2004. These suspicions led to the indictment and trial against former Defence Minister Berislav Rončević, who was eventually acquitted of all charges. Moreover, in the past year the domestic media have been reporting increasingly on the trial in the neighboring Slovenia, where former Prime Minister Janez Janša was convicted for taking a commission in the procurement of Patria vehicles for the needs of the Slovenian army. Since the same vehicles have also been acquired for the Croatian Army, the public observes with interest the trial in Slovenia, as well as the indictments brought against certain employees of Patria in Finland. Regardless of the fact that these “megacases” have outgrown the courtroom and entered the processes of media manipulations and political feuds, they have contributed to the creating of a better climate for fighting corruption in the traditionally closed security and defence sector.

1.2. Methodology

The basis and starting point for this study is the report by the Transparency International Defence and Security Programme (TIDSP) for Croatia published in 2013, whose methodology this study follows. The report was made after the evaluation of the Armed Forces of the Republic of Croatia and the Ministry of Defence in segments such as policy, staff, finances, tasks and public procurement in the period from July 2011 to November 2012. A new evaluation is currently underway for the report which will be published in 2015. According to the report, Croatia is placed in category C, which signifies a moderate risk of corruption.

This study uses the data gathered in the process of making the report and includes and analyzes various changes related to public procurement which happened within the defence system during 2013 and the beginning of 2014. For the needs of this study, we have taken from the report only the questions relevant for the acts of public procurement. There are nineteen questions in total, which cover the areas of legislature, procurement and planning, advertising, the setting up of contracts, offsets, and other. The answers to these questions are incorporated in four chapters:

1. The legislative and strategic framework – possible exemptions from the law
2. The public procurement procedure in the security sector and personnel training
3. The openness and transparency of public procurement
4. Supervision in the processes of public procurement

II The legislative and strategic framework and possible exemptions from the law

2.1. Public Procurement Law

The key umbrella law which regulates public procurement in Croatia is the *Public Procurement Law (ZJN)* adopted in 2011 and subsequently amended twice during 2013, but not in the section dealing with the procurement for the needs of defence and safety. Public procurement for the needs of defence and safety is regulated through the quite extensive Article 11 of the Law which generally defines the exemptions this Law does not regulate. Section 2 of Article 11 defines situations when this Law is not applicable and the procurement is regulated by the separate *Regulation of Public Procurement for the Needs of Defence and Safety* (hereinafter referred to as the Regulation). This includes the following public procurement:

1. military equipment, including any part, component and/or assembly of it,
2. equipment sensitive in terms of safety, including any part, component and/or assembly of it,
3. work, goods and services directly connected to the equipment from Clauses 1 and 2 of this Section for any and all elements of its life cycle,
4. work and services for explicitly military purposes and
5. work and services sensitive in terms of safety.

Individual terms mentioned in the previous article are defined in Article 2 of the ZJN. The *safety-sensitive equipment, safety-sensitive work and safety-sensitive services* are defined as equipment, work and services for the needs of safety which include, request and/or contain classified information. Military equipment is equipment specially produced or adapted for military purposes and intended for use as a weapon, ammunition or military material, especially the equipment stated in Appendix III to the ZJN. Furthermore, Article 11 also regulates those contracts to which the ZJN and the Regulation do not apply at all, i.e. the contracts which are completely exempt from public procurement procedures, and they are:

1. contracts to which special rules of procurement apply in accordance with an international agreement or arrangement concluded between the Republic of Croatia and one or more third countries,
2. contracts to which special rules of procurement apply in accordance with a concluded international agreement or arrangement which is related to the allocation of troops and pertains to the ventures of the Republic of Croatia, a member country or a third country,
3. contracts to which special rules of procurement of an international organization apply when this organization is procuring for its own needs or contracts which the Republic of Croatia must conclude according to those rules,
4. contracts in the case of which the application of this Law or the Regulation would cause the Republic of Croatia to disclose information the disclosure of which is contrary to Croatia's important safety interests,
5. contracts for the needs of the security and intelligence system organs,
6. contracts within a framework of cooperation programs which is based on research and development and which is jointly carried out by the Republic of Croatia and at least one member country, intended for the development of a new product and, if applicable, for the future phases of the entire life cycle of the product or parts of this life cycle. After the end of the cooperation program the member countries will indicate for the European Commission the share of the expenses of research and development in the total cost of the program, an agreement on the division of costs, as well as the intended share of the procurement for each country, if it exists,
7. contracts which are concluded in a third country, including those for civil purposes, when the forces are deployed outside the territory of the European Union if operative reasons require these contracts to be concluded with economic subjects situated in the area of activity,
8. contracts which are concluded between government bodies or the units of local and regional authorities of the Republic of Croatia and government bodies or the units of local and regional authorities of a member country or a third state, and which concern the procurement of military equipment or safety-sensitive equipment, work and services directly connected to such equipment, or work and services for explicitly military purposes, or safety-sensitive work and safety-sensitive services.

It is visible from this exhaustive list that there is a wide range of exceptions concerning public procurement in the security sector. Particularly striking is the fact that the conclusion of deals on the state level concerning the purchase or sale of weapons is not subject to any kind of procedures of public procurement, as is the fact that the bodies of the security and intelligence system (the Security and Intelligence Agency, the Military Security and Intelligence Agency, the Operative and Technical Centre, the

Information Systems Security Bureau and the Office of the National Security Council) are completely exempt from any kind of commitments concerning public procurement. The question remains open whether this kind of discretion is proportionate to the interest of the public to have information about the spending of public money.

Finally, Article 10 of the ZJN regulates the general exemptions from the public procurement procedure which are valid for all public institutions, and therefore for the defence sector, too. Here belong cases such as:

- employment contracts,
- services of arbitration and mediation,
- contracts and bids to which different rules of procurement are applicable and which are concluded or carried out based on special procedures of an international organization,
- contracts concerning the acquisition, lease or rent of existing buildings, other real estate, land or rights concerning them, regardless of the manner of financing
- services of research and development
- contracts for slots of radio and television broadcasting and similar.

2.2. The Regulation of Public Procurement for the Needs of Defence and Safety (the Regulation)

While the ZJN is mostly concerned with defining the exemptions from the law itself, the Regulation regulates in detail the processes of public procurement in the defence sector. At the same time, the Regulation does not concern the security and intelligence system, which is, as we have stated, completely exempt from the ZJN. The Regulation was adopted on July 26, 2012 at the session of the Government of the Republic of Croatia and it regulates in detail the various procedures of public procurement – the limited public procurement procedure, the negotiable public procurement procedure with a previous notice, the negotiable public procurement procedure without a previous notice and the bidding dialogue.

It is important to point out that Clause 9 in Article 6 of the Regulation exempts all contracts which contractees conclude up to the value of 70,000 HRK (VAT excluded). This amount will most probably be raised to 200,000 HRK, since the last time changes were made to the ZJN the limit for the exemption from the ZJN was raised concerning the procurement of goods and services in the estimated value of up to 200,000 HRK, and for the procurement of work, the limit was 500,000 HRK. The questions of procurement within these value limits are regulated by the act of the contractee. It is interesting that the Regulation itself has not predicted the exemptions concerning the procurement of work valued at less than 500,000 HRK, and, according to the current legislature, the procurement of work that falls under the Regulation must pass the public procurement procedure.

Apart from these exemptions, the Regulation itself predicts certain situations when the public procurement can be circumvented, i.e. its procedure can be drastically quickened or the deal can be concluded with only one bidder. More about this will be discussed later in the text.

2.3. The Guideline for the Procedures of Public Procurement in the Ministry of Defence and the Armed Forces of the Republic of Croatia (hereinafter referred to as the Guideline)

Although it cannot be considered a part of the legislature, an important improvement in the regulation of the procedures of public procurement in the Ministry of Defence is certainly the implementation of this Guideline. The Guideline was implemented on December 20, 2013 by the Minister of Defence, and it serves as a kind of guide for the persons in charge of carrying out public procurement in the Ministry of Defence. The Guideline regulates the procedures concerning the planning of procurement and the creation of yearly plans of procurement, the ways of procuring goods, work and services in which the Ministry and the bidder conclude contracts of public procurement, and the competence of structural units within the Ministry of Defence. The Guideline recognizes the possible risks in public procurement (for example, wrong estimates of the necessary quantities, failure to comply with the conditions of the procedure, discrimination within the bidding documentation which favours a certain economic subject, etc.), as well as the measures for increasing the transparency and responsibility (the release of data on the Ministry's web site, the announcement of the Yearly Plan of Procurement, etc.). It should certainly be pointed out that the Regulation regulates the sensitive question of appointing persons into committees responsible for public procurement, as well as the form through which the persons from the bidding committees give the statement about the prevention of the conflict of interest.

Apart from the above stated, the area of public procurement in the area of defence is partially regulated through the following documents, which will be more thoroughly analyzed in the answers to specific questions:

1. The law on the production, overhaul and traffic of arms and military equipment
2. The law on the state committee for the control of the public procurement procedure
3. The law on fiscal responsibility
4. Criminal law
5. The law on defence
6. The instruction on the manner and conditions of the application of the "offset program"
7. EU resolutions.

2.4. Strategic documents concerning the public procurement in the area of defence

The key strategic documents which should reflect on the public procurement in the area of defence are the Strategy of National Security of the Republic of Croatia, the Long-term Plan for the Development of the Armed Forces of the Republic of Croatia 2006 – 2015, the Strategic Overview of Defence and the Strategic Plan of the Ministry of Defence of the Republic of Croatia for 2013 – 2015. Of the documents cited, the most outdated, and at the same time the most general document is the Strategy of National Security which is supposed to be the basis for the other strategies. An attempt to implement this Strategy in the past few years has failed, therefore the Strategy from 2001 is still in effect, and it has never been revised although the conditions have drastically changed (for example, Croatia is now a full member of the NATO and the EU).

It is interesting that in 2012 two strategic plans of the Ministry of Defence have been implemented, the first one in January 2012 for the period from 2012 to 2014, and only four months later, the Ministry implemented a new plan for the period from 2013 to 2015, which is probably a result of the change of government and the arrival of a new Minister of Defence. The last version of the strategic plan was adopted in May 2013 for the period from 2014 to 2016. These frequent changes of the strategic plan can be seen as the result of the change of the government, as the result of frequent budget revisions, but they can also be seen as the sign of a lack of quality planning. Precisely the strategic plan should be one of the key documents for the short-term (at least two-year) planning of public procurement. Nevertheless, the Ministry of Defence will remark that the basic strategic document for the making of a public procurement plan is, in fact, the budget projection document for the current and following year, made by the Ministry of Finance. The final scope of the public procurement is primarily defined by this document – that is, by the approved final funds in the state budget. Since the budget of the Ministry of Defence has been decreasing in the past three years, it has also reflected on the process of procurement. This is also the cause of a large part of unrealized priorities set in the Long-term Plan of the Development of the Armed Forces of the Republic of Croatia 2006 – 2015.

III The public procurement procedure in the security sector and the training of personnel

The public procurement procedure is an extremely demanding administrative and legal procedure which involves many technical details. In our case it is additionally “complicated” by the Regulation. Precisely in order to facilitate the public procurement procedure for the employees, the Ministry of Defence has additionally adopted the said Guideline. All the work concerning public procurement is concentrated in the independent sector for public procurement of the Ministry, which is therefore a separate structural unit.

Apart from the ZJN, the key document for the public procurement procedure is certainly the Regulation, which recognizes different forms of public procurement, such as the limited procedure, the negotiable procedure (with or without previous notice) and the bidding dialogue. The Regulation defines in detail the cycle of the public procurement in segments for which it is responsible. It defines the announcements of public procurement, the notices about concluded contracts, the participation, bidding and appeal deadlines, the reasons for exclusion and the conditions of competence of economic subjects, the technical specifications and the criteria for the selection of an offer, subcontracting, the possibilities of legal protection of the bidders, and the obligations of statistic reporting. The Regulation also contains seven appendixes (from the list of services, technical specifications to the bidding forms).

The regulation concerns three types of contract: the public work contract, the goods procurement contract and the services procurement contract, and it distinguishes four types of public procurement procedures:

1. The limited public procurement procedure (the procedure in which every interested economic subject can request participation in the procedure, but only those economic subjects invited by the contractee can place a bid)
2. The negotiable public procurement procedure with a previous notice (the procedure in which the contractee addresses economic subjects of his own choice and negotiates the conditions of the contract with one or more economic subjects)
3. The negotiable public procurement procedure without a previous notice
4. The bidding dialogue (the procedure in which every economic subject may request participation – based on an announced call – wherein the contractee conducts a dialogue with the selected participants, with the goal of developing one or more appropriate solutions which can satisfy his requirements, and based on which the selected participants will be called to place their bids). This procedure is applied when an especially complex procurement item is in question (an especially

complex item is defined if the contractee is objectively unable to specify the technical specifications or the legal and financial conditions of the project), and when the conclusion of the contract is considered unfeasible through the limited and negotiable procedures.

Each of the cited procedures is elaborated in detail in the Regulation.

For public procurement of bargain value (less than 200,000 HRK for goods and services, less than 500,000 HRK for work) the ZJN requires the contractee to regulate these procurement through his own act, which the Ministry of Defence has done through its Guideline. The Guideline also regulates those procurement procedures which are exempt from the ZJN (Article 10 and Section 3 of Article 11). In these cases the following is carried out:

1. Invitation to tender – invited are at least three economic subjects capable of business, who have proved themselves competent in their previous business with the Ministry or with other users of the state budget, or three competent economic subjects determined through the examination of the market analysis.
2. Two-stage tendering which consists of market analysis based on which economic subjects are invited to deliver their requests for participation in the procurement procedure, after which there is a kind of screening of the bidders (the competence and the acceptability of the request are evaluated). Those judged *competent* are invited to deliver their initial and final offers with the prices. The negotiation with the bidders can be done jointly or individually.
3. Direct negotiation
 - a) *with one bidder*, which is carried out when the needed goods, services and work can be obtained only from one economic subject
 - b) *with several bidders* and when the request for procurement does not clearly specify the type of goods, services and work, or when it is reasonable to conclude contracts with several economic subjects for the same purposes. In this case it is defined that the invitation for the participation in the negotiation must be addressed to at least two economic subjects.

3.1. Procedures and standards for the bidders

Procedures and standards for the bidders are regulated by the ZJN (Articles 72-77) and separately by the Regulation (Articles 25-28). In principle, proofs of technical and professional competence for the implementation of the contract are requested from the bidder, and if these proofs involve classified data, the appropriate certificates based on security screenings are requested. The technical specifications are additionally defined in the Appendix III of the Regulation, and Article 28 includes the appropriate national, European and international norms, as well as the characteristics related to the protection of the environment. It is also defined that excluded from the bid will be the bidders in the public procurement procedure if the economic subject and/or the person authorized by law to represent the legal entity of the economic subject have been legally sentenced for terrorism, financing terrorism, money laundering, public incitement to terrorism, recruitment for terrorism, training for terrorism and/or a terrorist organization, or for the corresponding criminal offenses according to the regulations of the country of the economic subject or the country this person comes from. Finally the Regulation defines two criteria for the selection of an offer: the criterion of the economically most acceptable offer from the point of the contractee (which can include the quality, price, technical advantages, functional properties, ecological properties, etc.) or the criterion of the lowest price.

3.2. The training of personnel employed in public procurement

It is visible in the managerial structure of the Ministry of Defence that within the Ministry there is a separate unit named the *Independent Sector for Public Procurement* which consists of two subunits: the Procurement Planning and Sale Service and the Procurement Implementation Service.

As part of the *Report on the Implementation of the Anticorruption Measures in the Area of Responsibility of the Ministry of Defence for the Period from January 1, 2011 to June 30, 2012*, along with the report on the measures already undertaken, the Ministry has suggested additional measures in the creation of the new Action Plan Complementing the Strategy of Fighting Corruption for the Year 2013. The suggested measures are concerned with the increase of capacities and capabilities of the *Independent Sector for Public Procurement* and with a systematic approach to the education of its employees. Both these measures have been accepted and incorporated in the plan. Additionally, in the new Report on the Implementation of Measures from the Action Plan Complementing the Strategy of Fighting Corruption from February 2014, the Ministry of Defence reports that all employees of the *Independent Sector for Public Procurement* have completed a specialist training program for the area of public procurement. It also reports that they have all passed the legal regulations exam and that they have the certificate from the Directorate for the Public Procurement System within the Ministry of Economy. Every employee regularly updates the needed knowledge by attending a training program in the total duration of at least 32 classes in the period of three years from the date of the certificates validity. The program is conducted by the bodies authorized for it.

3.3. "Offset programs"

Probably the most poorly regulated area in public procurement for the needs of defence is the area of offset. It is minimally regulated by the recently adopted new Instruction on the Manner and Conditions of the Application of the Offset Program which has been implemented by the Ministry of Defence and the Ministry of Economy, and which has been put into effect at the beginning of 2014. This Instruction has to some extent improved the area of offset compared to the previous regulation, but is still inadequate. Terms such as transparency, ethical conduct and anticorruption measures are not mentioned. It is noteworthy that the Instruction requests the conclusion of offset programs for weapons and military equipment procurement contracts in the amount of €2,000,000 (equivalent in HRK). Hence, offset has almost become a legal obligation in the conclusion of larger deals, and for any exceptions from the conclusion of offset programs, permission from the Ministers of Defence and Economy is required.

It is important to mention here the Committee for the Offset Program, which represents the state in the contracting and implementation of the offset program. The Instruction requires that the Committee is appointed by the Minister of Economy. The Committee is made of three representatives of the Ministry of Economy, three representatives of the Ministry of Defence, two representatives of the Ministry of Finance and one representative from both the Croatian Chamber of Economy and the ALAN Agency (the former Agency for the Control of Production for the Needs of Export and the Import and Export of Weapons and Military Equipment). The Instruction provides that at the request of the president of the Committee a representative of the President of Croatia may be included, as well as the representatives of government bodies and other relevant institutions. The Instruction further prescribes how the tasks of the Committee are defined by the Rules of Procedure of the Committee. The information about the manner of preparation and execution of the offset agreement is not publicly released, in accordance with the Law on the protection of the secrecy of information and the Regulation of the protection of the secrecy of defence information. The preparation and execution of the offset are, as a rule, of the same type and degree of secrecy as is the weapons and military equipment procurement in relation to which offset is applied. If the type and degree of secrecy of the procurement procedure are not determined, the offset procedure being executed is generally classified as a "business secret". From the stated, it is visible that the offset programs remain almost entirely in the domain of secrecy, which largely undermines their transparency. Finally, although a full member of the EU, Croatia still has not adopted the Code of Conduct for the conclusion of offset programs, which the European Defence Agency has opened for signing.

IV The openness and transparency of public procurement

Most public procurement by the Ministry of Defence are publicly released in the Official Gazette, while a part of the procurement are released on the Ministry's web page. Here it needs to be stressed that the criterion according to which the Ministry releases only certain public procurement on its web page is not clear. Nevertheless, there is a part of public procurement which are not publicly released, which is in accordance with the exemptions defined in the Articles 10 and 11 of the ZJN, which does not predict public procurement.

4.1. The release of the public procurement plan list

An important step forward was made with the release of the list of all the contracts which the Ministry concluded in the previous year and the ones which will be concluded in the following year. The Ministry of Defence, in accordance with the ZJN, releases the list of the plans of public procurement for the following year. The procurement plan contains information such as the object of procurement, the planned beginning of the procedure, whether it is a one-time contract or a framework agreement, and the amount predicted for the procurement. Moreover, for each planned act of procurement the corresponding legal articles are stated, so that the bidders know which public procurement procedure will be applied. What needs to be kept in mind is that in this release only the data which are publicly available are indicated, while there is no public data on the procurement classified or exempt by the Articles 10 and 11 of the ZJN. Procurement from this area are not clearly identified, except for certain cases defined by strategic documents (for example, the purpose of servicing the MIG aircraft).

Apart from the release of the contract list, the Ministry of Defence also holds sessions with the Defence Committee and with the members of the National Council for Monitoring Anti-Corruption Strategy Implementation at which it presents the procurement plan for the next year. For the time being, these presentations are open only for the members of the Defence Committee but not for the organizations of civil society and other interested public.

4.2. Classified public procurement

There are no public data on the number of public procurement that have been concluded without a release in the Official Gazette or on the official web page of the Ministry of Defence, but there are data on the total expenditure outside the ZJN and the Regulation. These data are found in the Audit Report for the year 2012 put together by the National Audit Office, and the amount equals 965,640,837.00 HRK, which makes up 67% of the total amount spent for public procurement by the Ministry of

Defence in 2012. The cited amount differs from the one presented by Defence Minister Kotromanović at the presentation on public procurement in February 2013 in the Croatian Parliament, where it was stated that the amount spent on secret public procurement was 840,370,223.00 HRK. These data demonstrate the difference in the amounts equalling about 125,000,000.00 HRK. A possible explanation of the difference is that it is the expenditure realized according to Article 10 of the ZJN, by using services which do not fall under the procedures of public procurement. Also noteworthy is the fact that on this occasion the Defence Minister announced a drastic reduction of secret procurement in 2013, which are supposed to amount to 154,287,087.00 HRK, which is a fivefold reduction. In the Yearly Defence Report for 2013 the Ministry of Defence states that the percentage of public procurement marked with a degree of secrecy is reduced to less than 10%, and the Ministry plans to reduce this number to 5.74% for 2014. Visible is the clear tendency to reduce the number of procedures of secret public procurement, but for the final results it is necessary to wait for the audit report for 2013 where it will be visible whether the set goals have been realized.

We should note that according to the Regulation, in certain situations the Ministry of Defence can initiate a public procurement procedure without previous notice (regulated by the Articles 8 and 9 of the Regulation), which greatly degrades the very purpose of public procurement. As it stands, the Regulation predicts the initiation of the negotiable procedure for the procurement of public work, goods and services without previous notice. This raises the question what is the purpose of public procurement if there is no previous notice, i.e., can something be called public procurement if its minimal integral part is left out.

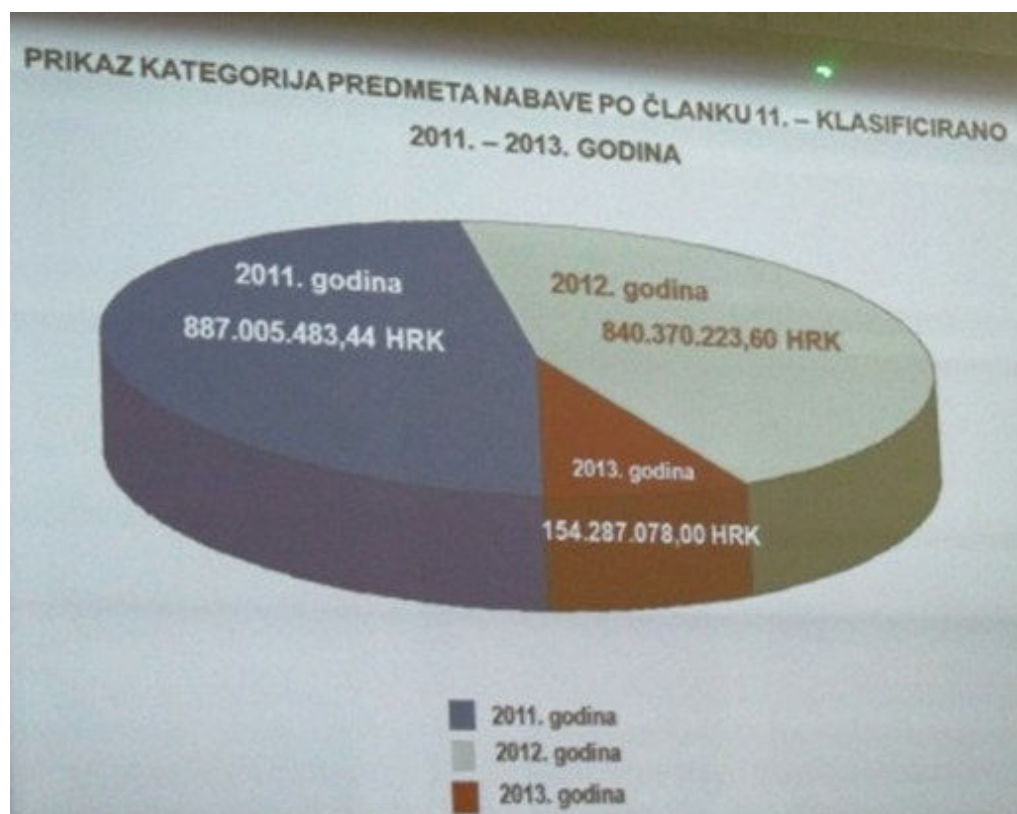


Table 4. Amounts spent through classified public procurement (image taken from the web page obris.org)

4.3. Negotiable procedure without previous notice

The next question which arises is to what extent public procurement procedures in the area of defence are indeed open contests and how many factors negatively influence these procedures and so bring about direct contracting. An aggravating circumstance for the execution of completely open bids is the extremely complex legal framework, as well as practical needs for the discretion and secrecy of certain procedures.

Out of the previously cited possible public procurement procedures, the most sensitive one is the negotiable procedure without previous notice. *The Regulation of Public Procurement for the Needs of Defence and Safety*, Articles 8 – 10, defines when this procedure is possible. The criteria allowing for the negotiable procedure not to be published and, therefore, for it to turn into direct contracting with one bidder are the following:

- if no offers, or no appropriate offers, have been delivered, or no requests for participation in the previously carried out limited public procurement procedure, the negotiable public procurement procedure with a previous notice or the bidding dialogue have been delivered, with the condition that the initial conditions of the contract do not change significantly, and that a record of evaluation of the initial and/or final offers has been sent to the European Commission, if requested
- if the delivered offers were irregular or unacceptable, under the condition that the initial conditions of the contract do not change significantly, and the contractee invites for negotiation only those bidders who have proven competent and who have, during the previous public procurement procedure, delivered offers in accordance with other formal demands of the public procurement procedure
- when the deadlines are defined for the limited and the negotiable public procurement procedure with a previous notice, including the deadlines due to urgency incompatible with a crisis-caused urgency
- in the case it is necessary if for reasons of extreme urgency caused by events the contractee could not have predicted, the deadlines in the limited or the negotiable procedure cannot be applied. The circumstances called upon to justify the extreme urgency must in no way be caused by the actions of the contractee

- when for technical reasons or reasons connected to the protection of exclusive rights the contract can only be executed by a certain economic subject
- for additional work, whose total value must not exceed 50% of the value of the basic contract, which has not been included in the initial project nor the basic contract, but has, due to unforeseen circumstances, become necessary for the performance of the work described in them, under the condition that the contract is concluded with an economic subject who is executing the basic contract, and:
 - a) when such additional work is technically or economically inseparable from the basic contract without significant difficulties for the contractee
 - b) when such work, although separable from the execution of the basic contract, are necessary for its completion
- for new work which consists of repeating similar work, which is given to the economic subject with whom the same bidder has already concluded the basic contract, under the condition that:
 - a) such work is in accordance with the basic project for which the basic contract had been concluded,
 - b) the basic contract is concluded in the limited public procurement procedure, the negotiable public procurement procedure with a previous notice or the bidding dialogue,
 - c) in the first invitation for bidding for the contract in the area of defence and security, the possibility of the application of a negotiable public procurement procedure without previous notice had been predicted,
 - d) the contractee has taken into consideration the total estimate of the cost of the new work during the establishing of the estimated value of the procurement,
- if the negotiable public procurement procedure without previous notice is only used within five years after the conclusion of the basic contract, except in special circumstances which are defined taking into consideration the expected life cycle of any delivered product, installation or system and taking into consideration the technical difficulties which the change of the economic subject might cause, whereby such special circumstances must be justified in the record of the evaluation of the initial and/or final offers
- for additional deliveries from the supplier from the basic contract which are meant either as a partial replacement of the usual goods or installations or as an expanding of the existing goods or installations, if the change of the supplier would oblige the contractee to acquire goods with different technical qualities, which would result in incompatibility or disproportionate technical difficulties in the work or maintenance. The duration of such contracts, as well as the contracts which are repeated, must not exceed five years, except in special circumstances which are defined taking into consideration the expected life cycle of any delivered product, installation or system and taking into consideration the technical difficulties which the change of the economic subject might cause, whereby such special circumstances must be justified in the record of the evaluation of the initial and/or final offers
- for goods which are quoted and acquired on the commodities market
- for the purchase of goods under especially favourable conditions from a supplier who has permanently ceased his business activities, or from a bankruptcy trustee or liquidator, or within a settlement with creditors, or within any similar procedure according to the national regulations of the home country of the economic subject
- when for technical reasons or reasons connected to the protection of exclusive rights the contract can be executed only by a certain economic subject
- for the services of research and development other than those from the Articles 10 and 11 of the ZJN

Along with everything stated, direct contracting is also possible in all cases which are included in the classified public procurement. These cases are exempt from the ZJN and the Regulation by the Article 11 of the ZJN.

4.4. The openness of the agreed financial package

When talking about the transparency, i.e. openness, of the processes of public procurement in the defence sector, the problem of the availability of information when it comes to the aspects of the agreed financial package arises. This includes deadlines for payment, interest rates, commercial credits as well as other credit arrangements. These data are available neither before nor after the conclusion of the contract. After the conclusion, the Ministry of Defence publishes the total settled amount and the deadline for the execution of the contract and for the time being, this is the only information available to the public. Moreover, Article 22 of the Regulation regulates the manner the information on the concluded contracts in the area of defence and safety is released, and it requires that the information is released in 48 days from the day of the conclusion of the contract or the framework agreement. However, Section 3 of the said Article mentions exceptions, i.e. certain data regarding the conclusion of the contract or the framework agreement. Certain data do not have to be released if the disclosure of such data would prevent the execution of law or would otherwise be contrary to the public interest, especially the defence and/or safety interest, or if it would harm the legitimate business interests of public or private economic subjects, or if it would harm fair market competition between economic subjects. Exceptions formulated this way are contrary to the Article 15 of the Right on the Access to Information Law, which clearly regulates when certain information can be denied to the public. Categories such as defence/safety interest, the prevention of the execution of law and similar cannot be grounds for denying information and. Therefore, this section needs to be coordinated with the Right on the Access to Information Law and the Information Secrecy Law.

4.5. The transparency of the bidding companies

Along with the previously cited questions of the transparency/openness of public procurement processes in the defence and security sector, there is the question regarding companies involved in these processes, which are hired through subcontracting by the main contractor. As it stands, these companies are not required to adopt anticorruption programs. We will add that the adoption of anticorruption programs is required neither from the main contractors. Although there is a special chapter in the Regulation which defines the criteria for subcontracting, among them there is no request for anticorruption programs, but the legislator calls upon the principal criteria which the main contractor has to satisfy according to the ZJN.

4.6. The prohibition of the discrimination of companies

Several sections of the ZJN prohibit the discrimination of the bidders and the discriminatory behaviour of the contractee. The discrimination in public procurement procedures is also dealt with in the Regulation, which explicitly states provisions on discrimination prohibition on twelve occasions (for example, the ban of discrimination via providing information only to certain bidders, the discrimination in the occasion of subcontracting on the grounds of nationality, etc.) and it prohibits the violation of market competition. Apart from these regulations, it is necessary to mention the general Law against Discrimination which also prohibits discrimination in the access to goods and services and their providing. For now there are no data whether there is a case of a company complaining of discrimination during a public procurement process.

4.7. Political influence

The problem of transparency can also be manifested through political deals which usually take place behind closed doors, and so the public is denied information and the chance to constructively contribute to these deals. Of course, these processes are very hard to prove. Although in the recent past there have been speculations that the decisions about the defence procurements are based on political influence, the current situation does not indicate that something of the sort is happening, or at least such influence is not visible. During the process of deciding on what to do with the military aviation (whether to buy new aircraft or repair the existing and prolong their usage), there appeared criticism that there is no wider debate on this subject. The Ministry of Defence decided on repairing the airplanes in Ukraine and it was considered that behind this decision stood the pressure from the USA, but the speculations were dismissed by the Embassy of Ukraine in the Republic of Croatia and by the Ministry of Defence.

V. Supervision and sanctions in public procurement processes

When it comes to the supervision of the public procurement processes in the defence sector, the situation is similar to the situation of transparency, which means that there is room for improvement. In the current situation, there are no mechanisms in the sense of continuous, independent and prompt supervision of public procurement processes, as there are no instances of integrity pact. The wholly *post ante* supervision, if there is an appeal, is carried out by the *State Committee for the Control of Public Procurement Procedures*. For the time being, there is no specialized and independent supervision of the public procurement in the defence sector.

5.1. The appointment of the committee for public procurement

There are no principal regulations which would regulate the choice and performance of the bidding committees. It is left to each contractee individually. The Ministry of Defence has regulated this segment through the mentioned Guideline, where the decision on the appointment of authorized representatives of the public contractee for the arrangement and execution of the public procurement is regulated to some extent. The persons responsible for the decision on the appointment of authorized representatives for the public procurement process are:

- the head of the independent sector for public procurement for decisions where the estimated value of the procurement is less than 5,000,000.00 HRK
- the Defence Minister for decisions where the estimated value of the procurement is more than 5,000,000.00 HRK

The Guideline also regulates the situations when the responsible persons are absent, and it regulates the mechanism of the transfer of authority for the decisions on the committee forming.

In certain cases (PATRIA, for example), there was also the so-called mixed committee consisting of high officials, such as the representatives of the President of Croatia and the Defence Minister, etc. This shows that the committee is formed depending on the "weight" of the procurement.

5.2. State Committee for the Control of Public Procurement Procedures

The decisions of the committees are subject to revision by the *State Committee for the Control of Public Procurement Procedures*, which is an independent state body responsible for dealing with the appeals in public procurement procedures, giving concessions and choosing the private partner in projects of public-private partnership (the president, vice-presidents and other members of the State Committee are appointed by the Croatian Parliament at the suggestion of the Government of Croatia, and the members of the Committee must not be simultaneously members of political parties. Also, the members of the Committee must not belong to any kind of affiliation with interests that could bring to a conflict of interests.). The State Committee in the appeals process decides on the legitimacy of the procedures, activities and the omissions of these, as well as on the decisions as individual acts made in these procedures. Also in the jurisdiction of this Committee are the decisions on other requests made by the parties of the procedure in the process of legal protection, as well as the submission of motions to indict for infringements prescribed by the *Law on the State Committee for the Control of Public Procurement Procedures* and other regulations dealing with the area of public procurement. All the decisions made in the appeals processes in front of the State Committee are publicly released on their web page. In 2013, according to available data, the State Committee received twelve appeals on the public procurement processes where the Ministry of Defence is the contractee. Of these, only in five cases did the State Committee decide on the merits. The rest of the cases concerned process suspension (five cases) and appeal dismissal (four cases). In all four cases of appeal dismissal, the appellants dropped their appeals and the State Committee based its decision on Article 164, Section 1, Clause 1 of the ZJN. In all four cases of appeal dismissal, the grounds for the dismissal referred to the payment of the appeals process fee. Before deciding on the merits, the State Committee must examine whether there is a formal and legal presupposition in accordance with the Article 159 of the ZJN. One of these presuppositions requests that the appeal contains proof of payment of the appeals process fee. In three cases the State Committee received no proof of the payment, while in one case the appellant submitted the proof of payment, but the Committee found it inadequate (UP/II-034-02/13-01/802). The State Committee dismissed the appeal in only one case. The Association of Bidders Žal ZP Adria-mar Shipbuilding d.o.o. Zagreb, Dalmont d.o.o. Kraljeвица, EPO – energy process equipment Orosavlje and Iel d.o.o. submitted an appeal on the decision which made it ineligible for the participation in the negotiable public procurement procedure with previous notice no. UP/II-034-02/13-01/1252. The object of the procurement was coastal patrol boats. In accordance with Article 12, Section 6 of the Regulation, the decision on ineligibility must contain reasons for ineligibility and it is delivered to every bidder separately so that no bidder has access to the data on other bidders. The State Committee found that such reasons were stated and that they referred to the fact that the

appellants had not proved the technical and professional competence in accordance with the bidding documentation. The State Committee also dismissed the proposal for setting up a temporary measure because the appellant had not proved or made probable the circumstances his proposal was based on. Some appeals do not have a suspensory effect, but the ZJN prescribes the possibility of issuing a temporary measure (Article 163).

In four cases the State Committee granted the appeal and annulled the disputed decision, enjoined the Ministry of Defence to reimburse the appellant the costs of the process, and, where it was necessary, annulled the public procurement process. In the case of the appellant City Gas Distributor Zagreb – Supply d.o.o. (UP/II-034-02/12-01/1165), the State Committee found that the Ministry of Defence had not followed procedural rules and that they changed the decision although the law does not grant them that. In the case of the appellant Tehno – Elektro d.o.o. Đakovo (UP/II-034-02/13-01/1176 and UP/II-034-02/13-01/1181), the State Committee found that the Ministry of Defence had not delivered the necessary documentation and so it was authorized to make the ruling without the documentation and without entering the question of merits. Finally, in the case no. UP/II-034-02/13-01/1229 of the appellant Protection and Security d.o.o. Zagreb, the State Committee annulled the decision of selection because the selected bidder had not provided all the documents in accordance with the ZJN. It is also necessary to mention that the State Committee is not the final jurisdiction in public procurement processes which are initiated on the occasions of legal remedies. The injured party has the right to initiate an administrative proceeding by submitting a claim to the Administrative Court.

Finally, here we need to point out the exceptions from appeals processes, which are regulated by Article 36 of the Regulation.

When deciding on the proposal for a temporary measure, the State Committee can reject the proposal, taking into consideration the possible consequences of the measure for the involved parties who may be damaged by it, including the public interest, and especially defence and/or safety interest, if it judges that the negative consequences surpass the benefits of the measure.

If the State Committee rejects the proposal for a temporary measure in accordance with Section 1 of this Article, then depending on the decision on the main subject it can determine a fine for the contractee.

When deciding on the annulment of the public procurement contract or the framework agreement, the State Committee can make a decision that keeps the concluded contract or framework agreement in effect wholly or partially although it was concluded contrary to Article 167, Section 1 of the ZJN if, taking into consideration all the relevant circumstances, it determines that the prevailing reasons concerning the public interest, and primarily concerning defence and/or safety interest, demand that the effects of the contract stay in force.

The concluded contract or framework agreement must not be annulled if the consequences of its annulment would seriously jeopardize the existence of a wider defence and/or safety program which is important for the safety interest of the Republic of Croatia.

The cited exceptions introduce categories such as “defence/safety interest”, for which it is not clearly stated who defines them, the contractee or the State Committee, and who eventually evaluates them.

5.3. The supervision of the Defence Committee

It needs to be mentioned that a small step forward was made in June 2013 when, through the changes of the Law on Defence, the Defence Committee of the Parliament was given the authority to give a preliminary opinion on the procurement for the purposes of defence whose value exceeds €5,000,000.00 to the Ministry of Defence. The opinion of the Committee is given before the procedure of public procurement is initiated. The Defence Committee has given a positive opinion on procurements larger than €5,000,000 on two occasions in the period up to May 2014. The first positive opinion concerned the procurement for the purposes of building interpolated storage facilities with the adjoining infrastructure on the VSK “Hrvatski ždral” Doljani (military storage complex “Croatian Crane”) worth 36,000,000.00 HRK. The second positive opinion concerned the continuation of the overhaul of helicopters worth 47,000,000.00 HRK. Nevertheless, it should be noted that there has been some criticism of the recent group contract signing with a handful of domestic companies concerning the public procurement of equipment for military purposes. The Ministry signed a seven-year framework agreement through 14 contracts worth around 66 million HRK with several companies. Although the total amount exceeds €5 million by far, the Defence Committee did not give any opinion on this procurement because this procedure was avoided by dividing the total amount into several smaller contracts.

5.4. Sanctioning abuses

An example of abuse is the association of bidders in order to manipulate the prices or even annul bids. This problem has been recognized and the sanctioning of such activities is defined in Article 254 of the Criminal Law.

If a party should place an offer in the public procurement procedure based on a forbidden agreement between the economic subjects with the intention that a certain offer be accepted by the contractee, the said party will be punished by a prison sentence in the duration from six months to five years.

If significant financial gain has been obtained by the criminal offense from Section 1 of this Article or significant damage has been caused, the perpetrator will be punished by a prison sentence in the duration from one to ten years.

Perpetrator who voluntarily prevents the contractee to accept the offer from Section 1 of this Article can be exempt from punishment.

The Criminal Law also recognizes misleading advertising (Article 255) and it presupposes the punishment of those who quote false or incomplete information in the offer of goods or services directed to a wide circle of persons, when this information is important for the conclusion of the contract and can mislead a reasonable consumer. A prison sentence of up to two years is predicted by the Criminal Law for such offenses. Here it is left unclear whether this applies to public procurement, i.e. whether there are sanctions, and if yes, of what sort, for misleading advertising in public procurement processes.

When talking about the Criminal Law, it is of extreme importance to remark that in the part concerning the abuse of position and authority it prescribes the punishment in the duration from one to ten years for the offenses of favouring, receiving/giving a bribe, trading in influence, etc. Equally, in the Law on the Conflict of Interests it is prohibited for officials to influence the attainment of deals or public procurement contracts, while sanctions for these offenses are determined by the Commission for the Prevention of the Conflict of Interest, which can warn the official or suspend the payment of a part of his monthly net salary.

As an end to this chapter we will shortly address the role of the Government in the whole process of public procurement, i.e. to what extent the representatives of companies and mediators are supervised. As it stands, Croatian legal regulations in no way regulate the role of possible mediators in the processes of public procurement. This means that their role must be in compliance with

the ZJN, the Regulation, the Criminal Law and other legal acts. Since this area of public procurement is not separately defined, this subject should be examined and the actual role of mediators determined, and regulations should be introduced to regulate their actions and so reduce possible irregularities.

VI Conclusion and recommendations

The Republic of Croatia has made significant steps in increasing the transparency of public procurement in the defence sector, primarily in the area of legislature development, supervision of public procurement processes and release of information concerning public procurement. At the same time, legislature concerning this area is extremely complicated and includes numerous exceptions, and requires extreme competence from the employees working on these issues. There is room for improvement in the legislature itself, especially concerning the many exemptions from the Law. All interstate agreements on mutual purchase/sale of weapons and military equipment are excluded from the public procurement process. Although greater business transparency is also desirable at this level and although certain information should be made available to the interested public, it is understandable that such progress is currently unrealistic, especially if taken into consideration that there is still sufficient room for improvement on the national level. Since the situation in the security sector (VSOA, SOA, OTC, ZSIS, UVNS) is the most critical one, it would be useful to gradually open these institutions since they are completely exempt from public procurement processes and are left entirely to internal control. The fact that even the state audit has never performed the supervision of these institutions points out the excessive closeness of these institutions for the area of public procurement. An additional visible problem is the lack of strategic planning of procurements for the area of defence since Croatia has for many years lacked the key strategic document: the Strategy of National Safety, based on which other documents should be created. Therefore it is necessary to approach the creation and implementation of this document as soon as possible.

Probably the most important step has been made with the significant reduction of the number of classified public procurements and the transparent publishing of the procurement plan on the Internet pages of the Ministry of Defence. Equally, the Ministry of Defence releases only certain bids on its web page, while all public bids are released in the Official Gazette. Since the logic and the criterion for such selective release on the Ministry's web page are unclear, they should be more clearly defined or all bids should be posted on the Ministry's web page. What could be improved in this segment is the release of more information on the aspects of the signed contracts. As it stands, for now the public has no access to the more detailed information on the concluded deals, such as payment and execution deadlines, penalties for not executing the work, etc. Although this information can in certain cases be a business secret, we believe that in most cases they can be public, which would also allow the Ministry of Defence to additionally protect itself from the possible manipulations of the contracts by the companies. Especially problematic is the area of regulating offset contracts, which is almost entirely out of reach of control by the public, since the information on the programs are classified as secrets or business secrets. At the same time, the fact that offset contracts are practically mandatory for contracts exceeding €2,000,000.00 can cause a series of corrupt practices. For this reason the Republic of Croatia needs to approach the issue of offset much more seriously, it needs to regulate it through legislature, and not through guidelines, and finally, it needs to adopt the Code of Conduct in concluding offset programs, which the European Defence Agency has opened for signing.

Through the process of public procurement the Ministry of Defence also has the opportunity to improve the level of transparency of the companies it does business with. Although the Regulation prescribes particular criteria which the companies must satisfy and guarantees the prohibition of the discrimination of the companies, it is possible to additionally request from the companies to adopt anticorruption programs, or at least from those companies applying for larger bids. For now, the Ministry of Defence does not request from the companies to position themselves more explicitly with regard to anticorruption programs within the companies themselves.

Finally, institutional mechanisms of supervision of public procurement exist but also provide space for improvement. Apart from the internal mechanisms in the Ministry of Defence, it is important to point out that, at least on a symbolic level, the role of the Defence Committee of the Parliament, which gives its opinion on large procurements, has been strengthened. However, there is room for the reinforcement of parliamentary supervision of public procurement procedures in the way that the capacities of the Committee can be expanded in order to directly supervise certain cases of public procurement. An important institution is certainly the State Committee for the Control of Public Procurement Procedures, which is responsible for the control of all public procurement processes in Croatia and does not have a separate unit for public procurement in the area of defence. Considering that the number of appeals to the Committee was relatively low in 2013, it is necessary to additionally examine to what extent the appellants are satisfied with the work of the Committee. For the time being, the Ministry of Defence practically does not cooperate at all with the organizations of civil society which deal with fighting corruption. Therefore, this is an area where improvements in cooperation are possible.

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Appendix – brief table representation of strategic documents, plans, supervision, laws and reports connected to the public procurement process in the defence sector.

Strategic documents	Procurement plans	Supervision/ audits	Laws	Reports
Strategy of National Security	Procurement plan of the Ministry of Defence for 2014. State Budget	State audit	Public Procurement Law	Report on the Implementation of the Anticorruption Measures from the Action Plan
Long-term Plan for the Development of the Armed Forces 2006 – 2015		Internal audit of the Ministry of Defence Committee for the supervision, control and deciding in project management	Regulation of Public Procurement for the Needs of Defence and Safety	Report of the National Audit Office
Strategic Plan of the Ministry of Defence		Croatian Parliament – Defence Committee	The Guideline for the Procedures of Public Procurement in the Ministry of Defence and the Armed Forces of the Republic of Croatia	Yearly Defence Report for 2013
Strategic Overview of Defence 2013		National Council for Monitoring Anti-Corruption Strategy Implementation at the Croatian Parliament State Committee for the Control of Public Procurement Procedures		

About the Centre for Peace Studies (CMS)

The Centre for Peace Studies is a non-governmental organization from Zagreb founded in 1997, which, among other activities, works on the promotion and development of public policies concerning the concept of human safety. Human safety arises from the needs of every individual and it is connected with the recognition of the needs of all the people who live on the territory of a certain country. We hold that the previous development of policies concerning the concept of national security has contributed to the abuses of human rights and the promotion of violence, since the “national interests” are placed before human life. Within this program we are especially concerned with public policies connected with the work of the police, security and intelligence agencies and the military. We are focused on the monitoring of the said institutions with regard to questions of human rights abuse and the transparency of their work. Through our monitoring and advocacy activities we wish to work on the transformation of these institutions, which should become transparent, work in the service of the citizens and which should not violate human rights or promote violence.

About the project “Public interest – not saleable (PINS)”

PINS is the first project of the civil society connected to the defence and security sector financed by the European Union. The project is intended for monitoring possible risks of corruption in the defence and security sector of the Republic of Croatia.

The main idea of the project is the enhancing of the capacities of non-governmental organizations, helping the media, the citizens, the parliamentary bodies and the academic community in reporting, monitoring and detecting possible corruptive processes, as well as enhancing the participation in the forming and making of decisions of public interest.

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