

## MARKET MECHANISMS FOR DEMOCRATIC CONTROL?

Henrique Schneider<sup>1</sup>

<sup>1</sup> Chief Economist, Swiss Federation of Small and Medium Enterprises *sgv*, Schweizerischer Gewerbeverband *sgv*, Schwarztörstrasse 26, Postfach, 3001 Bern. Tel +41 31 380 14 38  
Mobil +41 79 237 60 82. Email: [h.schneider@sgv-usam.ch](mailto:h.schneider@sgv-usam.ch)

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### Abstract

This paper analyses private military and security companies (PMSC) as opposed to the traditional military regarding their respective democratic control. After reducing the question to an economic model by broadening the model allowing it to include political and social expectations as well as costs of matching those, this paper addresses two explanations on the rationale behind the compared agents. First, classical state-agents were found to operate minimizing total costs, including social costs, especially the cost of expected damages and those of avoiding damages, hence producing a social optimum for control. Here, the concept of damage includes all social desiderata and their opposites. PMSC on the other hand also minimize their costs, however, they try to operate on a higher level of avoidance costs because the costs of damages usually do not concern them before the damage occurs; if this happens, their cost curve increments making it extremely expensive to handle their mandate. According to the model, both, state-controlled military as well as PMSC can operate at an optimal level of democratic control. PMSC however, if contracted under strict rules of liability and contractual penalties, can provide a better outcome than social and democratic control would.

**Key words:** military, democratic control, armed forces, private security providers

### Controversy, Intuition and “the Battleground”

Private Military and Security Companies (PMSC, for a quick overview on their activities and history, refer to Feichtiger and Braumandel 2008)<sup>1</sup> are often perceived as entities operating in some realm which is intuitively assigned to state-institutions while at the same time escaping democratic control. Defense in its broader sense is assumed to be crucial for the (humane) security of a state and since it is closely related to the potential use of coercive power, it generates some feeling claiming for a state monopoly over it. A second intuition takes the mechanisms of democratic control to automatically be able and best suited to monitor the use of coercive power by the state.

While the first inclination might be right, the second is certainly wrong, since there is no factual example for a system in which democratic mechanisms are extended to control all, especially operational, processes in Defense Ministries, the military and alike. Better said, democratic control focuses on the top-level. Certainly, the ministers and secretaries themselves normally report to the Parliament; the legislative branch can start interrogations and special hearings and it has some instruments of control over the military – but these are often set in motion after undesirable outcomes are noted, i.e. these mechanisms perform rather correcting than preventing or controlling.

Both before-mentioned intuitions in their conjunction potentially disadvantage PMSC without reason by imposing an onus of “proof of good” from which state institutions are generally dispensed. Usually, it is taken for granted that state-institutions – since being controlled by democratic mechanisms – are better able to handle the coercive power they have been entrusted with. On the other hand, PMSC – since lacking democratic mechanisms – have to prove their ability to use this power.



The following non-exhaustive list gives some arguments forwarded by different think tanks in their call for a tighter control of PMSC (here exemplarily quoted from Flückiger 2008)<sup>ii</sup>:

- There is a need for new legal base to regulate PMSC activities.
- Strict licensing requirements, specific codes of conduct as well as special control and reporting procedures have to be introduced.
- Public awareness of PMSC issues must be enhanced and detailed information concerning the frequency and significance of the use of PMSC must be made available.
- Voters need to pressure their representatives for a commitment towards a transparent, honest and truly representative engagement in politics.
- PMSC armed engagement on the battlefield is undesirable.
- PMSC should not be used at all to provide public security and defense.

These and theses alike confuse two different lines of argument, a morally motivated dismissal of PMSC and the claim for more legal control. While not addressing the moral issues, this paper tries to answer the call for legal regulations taking democracy as being a sufficient basis for controlling PMSC.

This paper, starting from an economic rationale of control, investigates the following claim: If democracy provides the best mechanisms to control the state, then free markets provide the best mechanisms to control PMSC. Just as democracy can be assessed as a market for political ideologies in which some ideas are bought when parties and politicians are voted for, or dismissed when parties and politicians lose elections, market dynamics provide most of the instruments that are needed to control PMSC. Of course, markets are more than just prices and quantities, markets are also about regulatory environment. Five characteristics could frame the preconditions for a proper development and inclusion of PMSC. These five determinants could be outlined as follows:

- First, a solid legal basis is needed; treating security and defense as services that can be traded in markets just as, say, consulting mandates or procedural guidance from barristers.
- Second, the legal framework must guarantee free markets with competition. On the one hand, this turns PMSC into “normal” market players contributing thus to their demystification easing the discussion about their products. On the other hand, all advantages of free markets and competition can be transferred to the security and defense market, like increasing the quality of products, intensive public scrutiny, and applying rules of good governance and alike.
- Third, as a consequence of the second, the legal framework guaranteeing free markets has to discourage oligopolies and monopolies, especially state-granted advantages over the free markets.

However, these three points together do not safeguard more or better control over specific relationships. For this, more market mechanisms can be used.

- Fourth, specific contracts have to reflect the specific needs of the customer. Just as customers in almost all contracts have special control rights or have the right to impose punishment clauses (for example, contractual penalty), imposing these would help the contracting public bodies in controlling PMSC.
- Fifth, the contractual penalties have to be designed very specifically and aiming single individuals to be held accountable for their actions. By this, principal-action risks can be diminished.

By imposing contractual restrictions and using punishment clauses – as example – PMSC can be controlled more specifically and more effectively than by abstract democratic instruments which often neither rely on popular scrutiny nor are fine grained enough to perform the intended tasks. This paper will focus on how these instruments are in many ways superior to the control the public has over state-agents.

### **Methods and Definitions**

For the aims of this paper, democracy will be understood as a market: different political entities offer a product in form of a contract over time with a specific content (may it be ideology, a program, aesthetics, etc.) that some or many citizens are willing to “buy”. Buying the product means voting for a given entity (Dahl 1985 and 1998)<sup>iii</sup>. In this dynamic market, the product has to be regularly re-sold or its adaptation has to be made attractive; that is, the party has to be re-elected. On the other hand, the “consumers” (voters) have some degree of control over the product they bought, first, because they are informed how those politicians who embody the product and market it themselves perform and second, because there is a feedback-loop for example in the form of opinion polls (Przeworski et al. 1999)<sup>iv</sup>.

Note, however, that the consumer has no direct power to change the product or the baskets of products she or he bought over the time of the contract (usually two to five years). Normally, the definite feedback is the next round of the market game, the election. During the lasting while of the contract, politicians try to implement the product they marketed. Of course, they do so facing important constrains, for example administrative necessities, budget restrictions, the corps of civil servants, which are not to be re-elected and have a guaranteed contract with the government. Since this last group is more likely to stay longer in their respective positions, they are also more likely to have informative advantages over the elected politicians who (to their own advantage) recognize this and usually let the civil servants work in their own dynamics (for the sake of efficacy and efficiency and so to the advantage of all).

This last and important constrain qualifies as a good explanation for the fact that democratic control usually extends to the parliamentary work or to the work of the Parliament in conjunction with the top level executive, but seldom to the operative echelons of the public administration.

The political parties or other political entities control themselves in the legislative almost at a timely basis, but the administration is almost only controlled ex-post. It would be too costly – in an economic sense, this means that all determinants of actions can be considered as costs; opportunity costs – to try to control the informational advantage the civil servants have at the same time risking to give up their dynamics which usually makes the public service work as expected.

What does democracy give back to the customer? It gives him or her a range of choices for contracts with limited feedback which can be renewed or not for a given period of time. There is a strong intention on the side of the suppliers to comply with the contract because the consequences of losing it usually outweigh the cost of the efforts needed to succeed in the view of the customers, this means, being re-elected is better than losing. This being the rationale of the democratic model, the same can be used for explaining other services, the contracting of PMSC as an example.

This paper has a very broad definition of Private Security and Military Companies. The term private military (and security) company (PMSC) does not exist within any current international legislation or convention. One definition of a PMSC is: “a registered civilian



company that specializes in the provision of contract military training (instruction and simulation programs), military support operations (logistic support), operational capabilities (Special Forces advisors, command and control, communications, and intelligence functions), and/or military equipment, to legitimate domestic and foreign entities” (Goddard 2001)<sup>v</sup>. A more general definition of a PMSC is: “a company that provides, for a profit, services that were previously carried out by a national military force, including military training, intelligence, logistics, and offensive combat, as well as security in conflict zones” (Brooks, 1999)<sup>vi</sup>.

Not all PMSCs are alike, nor do they offer the same services. Understanding of the industry is seriously hampered by the fact that no clear distinction exists among the different services offered, attuned to the unique blending of business and military features that defines the private military industry. Because PMSC operations are often controversial, some firms try their utmost to cover up the scope of their activities. Others prefer to call themselves Security Company in order to attract less attention from the media, to have a better claim to legitimacy or less reason to fear regulation. Services offered are usually (Campbell 2000)<sup>vii</sup>:

- Consulting: may cover anything from advice on reforming and restructuring of the armed forces to establishing democratic control over the armed forces; assisting ministries of defense to establish policies, procedures, and decision making for defense planning as well as for the procurement of weapons and equipment; establishing command and control, doctrine and force development; to strategic, operational or tactical planning.
- Training: is a major activity by PMSC, often directly linked to combat.
- Logistic support: is provided by the largest number of PMSC.
- Maintenance and Military Providers.
- Intelligence, reconnaissance, surveillance, and monitoring: is performed by a number of corporations specialized in intelligence, satellite and aerial reconnaissance, photo interpretation, and analysis as well as in SIGINT and MASINT, psychological and information warfare.
- Demining: is handled by specialist companies and as part of a wider security package.
- Belligerence.

In this sense, PMSC offer a wide range of services, many of which are also core competences of military organizations, the police and alike. One of the many consequences of this is that PMSC can engage a competition with state-institutions although they normally try to complement them. Usually, entities that are prone to compete with each other can be assessed by market mechanisms; this being the next step for a comparison.

In the following, the market-model for controlling PMSC will be tested. For this, two assumptions are needed. First, let cost be defined in a broad and social sense: cost is whatever efforts are consumed in order to achieve or correct a certain state of affairs. Similarly, many of the following concepts like caution, damage et al. will be understood in a broad sense: they will be defined as effort in a social sense, which can be monetary or budgetary cost but can also mean more, like all measures the executive has to take to re-establish the status quo. Second, let accept that there is a situation with two possible but mutually excluding state of affairs:

S1: Military in the traditional sense is deployed to a mission. If it makes mistakes, this has to be investigated and corrected by the Department of Defense according to the law.



S2: PMSC is deployed to a mission. It has a mandate according to the five desiderata sketched in the introduction.

What are now the control instruments working in both scenarios?

### **Absolute and tortious liability as democratic control**

After defining both concepts of liability, this section examines how control can be better achieved by using one of them. Better control, in order to clarify once again, will be understood as what democratic governance might consider desirable. As mentioned before, democracy is a market optimizing political decision-making as well as the efficacy and efficiency of the state. As a dynamic system it aims to maximize political utility as envisaged by the principal – the people – and at the same time to minimize the total costs of state-running.

This particular choice for liability has first to be explained. In an economic sense, control means asking for responsibility, i.e. asking for the agent that is liable if the contracted outcome is not realized. According to this rationale, if an agent fails to achieve a given outcome under given constraints, he becomes liable. Liability arises from partial as well as from total failure; it also arises from defying the constraints. Economically seen, the possibility of creating damage per se calls for liability.

Absolute liability means that an agent is liable for all damages – here; damages are deviance from the social desiderata of military actions – caused by him or his actions. This concept of liability bases upon the differentiation between principal and agent. The principal gives the desired end-state of an affair and the agent is entrusted in producing that end-state. Under the concept of absolute liability, the total cost of an occurred damage while the agent tries to implement the desired end-state has to be paid, once the damage materializes. However, this total cost can only be stipulated after the damage itself occurs, since it is based upon the idea of causality and this can only be judged after a process and very seldom during its taking place.

From the perspective of democratic control, it is rather doubtful whether the principal should be interested in having the damage first to be compensated for it by the agent in a second step. Ideally, democracy assumes that the methods of control could help preventing any damage, but since political entities – whose aim is, among others, to be re-elected – are interested in pursuing those projects that can derive the highest success that can be changed into arguments for its own re-election, other projects – including many security-policy related endeavors – are left to those used in handling them, to the civil servants. This system usually proves to be good for all: the public, political entities and the civil servants.

Its main flaw is once again that the liable agents, even if they usually pay a price, only do so in the aftermath of the damage. The question is, if there may be an alternative that only changes this system in so far as every agent would be interested, from the beginning, in minimizing perhaps other than total costs. The concept of tortious liability can be of use.

In this case, and opposed to absolute liability, the agent pays for acting against the necessary preconditions of caution imposed to him by the contract or by the market median. Here, the agent compares the gains derived from deviating from the preconditions of caution imposed to him (economically speaking, the agent minimizes marginal costs of avoidance) versus the cost of the paying the compensation by doing so (economically speaking, the agent minimizes the marginal cost of being incautious). Here, the agent will be trading-off





both and minimizing the total cost; as the model will show, even more (Schäfer & Ott 2005<sup>viii</sup>; Rossato 2001<sup>ix</sup>).

According to this concept, the agents will try to find the one single point allowing them to operate within the limits imposed by the contract but at the same time allowing working efficiently. By this, the agents will work projecting possible outcomes of their decisions figuring different ways of optimizing costs before any damage is caused. By being future-oriented, the concept of tortious liability assumes that some form of constrain is set – and this may be socially – and all agents act within these limits. This means, the agents would continue to pursue their aims but dynamically incorporating the principal's desiderata – especially the consequences of harming them. By doing so, this would prevent bigger damages to occur while minimizing the total cost of projects.

How does this rationale help in deciding whether the state of affairs S1 or S2 is more desirable and most important, how does this model implement democratic control over PMSC?

### **PMSC, tortious liability and democracy**

In the second section of this paper, two possible states of affairs were introduced:

S1: Military in the traditional sense is deployed to a mission. If it makes mistakes, this has to be investigated and corrected by the Department of Defense according to the law.

S2: PMSC is deployed to a mission. It has a mandate according to the five desiderata sketched in the introduction.

In this section, the economic rationale behind each of these states of affairs will briefly be commented in the light of the section before. S1 is a typical situation in which – in this hypothetical trade-off – absolute liability fits the rationale. Political agents usually know in a non epistemic sense what caution level the broader society – their market – wants; since their credibility and freedom to operate depend on this, they calculate the cost of potential damage and usually can predict how much governance is needed to keep the total cost to a minimum. These costs can include, but are not limited to, paying off investments, setting up mechanisms for controlling and control, explaining to the society the rationale behind their actions, gathering information, incorporating new developments into their pattern of decision making and so on. Political agents will trade-off these costs against the potential damage caused by a failure in their system of governance; once again, the damage can be, but is not limited to the following, material and financial losses, deaths, public repudiation, obstruction by the parliamentary opposition, gaps in coordination, PR damages, loss of credibility. Since it is supposed that those expected damages can be quantified, it refers to the risk of their realization.

In the S1 situation, all political agents will be eager to minimize the total cost of expected damages and of those instruments intended to avoid damages; hence, the social desired degree of caution on military or related missions will most likely be enhanced. Of course, this seems to indicate that the intuition according to which the democratic state can provide the means to control coercive power in such a way as to achieve the principal's – the people's – goals correct. It doesn't follow, however, that the state-agents are superior to other agents, as will be shown now (On a separate note, it seems, however, to provide a good explanation for the moral skepticism with which PMSC are treated; if S1 is an optimal state of affairs, how can S2 be better? The arguments against this moral intuition will be left for other essays).

In the S2 situation, motivations are different because it is cheaper for PMSC to maintain their cost levels at the avoidance perimeters because if damages materialize, they



are faced with incremental cost consisting of their cost of avoidance plus the costs generated by the damages or by the measures needed ex post to correct them. For PMSC operating under a carefully drafted contract with contractual penalties, it is better and cheaper to be more careful than for state-institutions like the military. In other words, as long as the PMSC are careful and comply with their contractual duties of caution and avoidance of general damage to the contracting institution, they tend to employ more means in reducing the risk of damage than state-agents do. The motivation for PSMC is the possibility of stepped costs at the very moment they operate at the optimum set by S1. At that optimum, they are confronted with the costs of avoidance (the one they pay anyway because of the contract) and with those generated by expected damages (stepping on top of avoidance) and have hence the same cost structure as the state without any comparative advantages. Indeed, if they operate at S1, they are in direct competition to the state-agents, the ones which tend to have more backing by political organizations and by the public in general; and this seems to be a difficult competition (see the appendix for a formal treatment).

The outcome of this comparison is strangely contra-intuitive. Even if at S1 a social optimum is achieved, S2 out-performs S1 due to the higher level of caution PMSC have to employ in order to be better than state-agents. This means that considered from the point of view of the desired end-state of democratic control, PMSC will perform at worst at the same level of caution that state-agents, at best better, but never worse. Naturally, there are some pre-conditions for this outcome. The first and most important is the factual contract between the state and the PMSC. In this, PMSC have to face severe contractual liability clauses in order to operate as described here. Furthermore, the PMSC itself would be well advised in implementing a system of tortious liability with its own sub-contractors.

Note however, that there still are some indentified problems like accountability, the coordination of diverse PMSC, their control with a clear mandate and alike that also can be traced with the economic rationale presented here. The political problem of legitimacy, however, is left to be solved by the only instance with that capability: the political discourse.

## **Conclusion**

This short paper began by hinting towards a highly moralized rhetoric as what the employment of PMSC as opposed to the traditional military is concerned. After reducing the question to an economic model by broadening the model allowing it to include political and social expectations as well as costs of matching those, this paper addressed two explanations on the rationale behind the compared agents. First, classical state-agents were found to operate minimizing total costs, including social costs, especially the cost of expected damages and those of avoiding damages, hence producing a social optimum for control. Here, the concept of damage includes all social desiderata and their opposites. PMSC on the other hand also minimize their costs, however, they try to operate on a higher level of avoidance costs because the costs of damages usually do not concern them before the damage occurs; if this happens, their cost curve increments making it extremely expensive to handle their mandate.

According to the model, both, state-controlled military as well as PMSC can operate at an optimal level of democratic control. PMSC however, if contracted under strict rules of liability and contractual penalties, can provide a better outcome than social and democratic control would. This is of course an important argument against those who fear that the so-called lack of democratic control over PMSC could lead them to act irresponsibly. At the same time, this is also an argument against those pleading for more regulation of PMSC. To the contrary, these models show that PMSC can only out-perform state-agents if the market



is deregulated and allows for competition. Ultima ratio, these models rebuke all these expressed in the introductory remarks to this paper. It does not mean, however, that PMSC can be contracted without constraints.

These models make a strong case for using PMSC as efficient, effective and democratically controlled experts in many ways to complement or even substitute state-agents. It also makes the case that under the constraint of this economic model, the employment of PMSC also cope with the Simons' test as well as with the Carnovale-Simon's test (Rossato, *An economic analysis of liability rules*, 87 – 93). It does, however, make an equally strong case to contract them with very carefully drafted contracts with nuanced instruments of contractual liabilities since these are the levers ensuring the well-functioning and the caution of the PMSC. This also means that this paper makes a strong case for the state-agents, once they contracted PMSC, to control them tightly, for example by subduing them to military law, analogue to private industries monitoring their suppliers and service-providers.

A close look at issues of outsourcing (or privatizing or contracting out) reveals that the military and security sector raises formidable challenges to this process. The many contingencies of military operations and security activities make the development of the terms of contract a highly sensitive issue. This model suggests that carefully managed contracting can, under the right circumstances, provide specialized expertise, save money, and result in improved service delivery. It also hints, however, that poorly managed outsourcing, or privatization under the wrong circumstances, can lose money and result in poor delivery. Poor delivery in the military context, however, can dangerously compromise a country's credibility, flexibility and capacity for rapid reaction. In addition, it could be claimed that many transaction costs of contracting out are not fully taken into account. The costs of managing contracts, including arranging bids, monitoring outcomes, and taking legal action for contract failures, may offset any efficiency savings. This remains, however, open for discussion, since the caution level can also be set incorporating these costs.

Like other corporations, modern PMSC operate as companies that focus on their relative advantages in the provision of military services. They target market niches by offering packaged services covering a wide variety of military skill sets. As business units, they are often tied through complex financial arrangements to other firms within as well as beyond their own industry. Many PMSC are subsidiaries of larger corporations listed on public stock exchanges. Particularly for some of the military-oriented multinational corporations in the US, the UK, and in Canada, the addition of military services to their list of offerings can help them to maintain profitability in times of shortages of public contracts. And for those multinationals engaged in the mining and energy extracting sectors, links with private military and security companies provide a welcome means for the management of their political risks in dangerous areas and volatile situations abroad (Singer 2007)<sup>x</sup>.

Contracting out to private companies, agencies, or other intermediate types of administration has a place in efficient government. Privatization and outsourcing can reduce public spending and increase efficiency, while still responding to democratic control. Outsourcing made industry more competitive in the 1990s; it can do the same for the military. Using contractors saves money and frees up the military to concentrate on its core missions.

Not only are PMSC generally more efficient and more flexible than regular armed forces, in some circumstances they are also better placed for rapid deployment and thus have the potential to make a legitimate and valuable contribution to international security. PMSC offer governments a "surge capacity" and can be mobilized on short notice to add to





existing military capabilities. Without these companies and that surge capacity, the US would have to maintain a much larger standing military.

Contracting out ensures that Western governments do not have to risk incurring the political costs associated with sending their armed forces into situations that are little understood or supported domestically. Moreover, casualties among PMSC employees would not cause the same political problems that the deaths of a country's armed forces do. Employing the military for non-combat operations weakens the military by distracting it from its core mission of fighting wars. During the 1990s, the military was often deployed in response to ethnic conflicts and collapsed national governments. It is however doubtful, whether the armed forces should not be used in actions that are not fundamental to national security, such as drug interdiction and nation-building. Since the 1990s, there has been a trend toward civilian authorities directing the military to undertake such tasks.

In this sense it would be worth to work contra-intuitively and carefully examine the situation of the PMSC. Most people trust that it is better for them to outsource important decisions concerning their lives, like for example sending their children to school. Schools usually perform well; so why should not PMSC perform equally well, if the conditions are carefully prepared?

### **Appendix**

The formalization of both concepts of absolute and tortious liability can be as follows (Endres 2000)<sup>xi</sup>:

Taking into account that the economic concept of cost is a broad concept allowing for social desiderata, image, good standing in public relations, and so on to be considered such, the total cost (TC) of implementing and controlling military missions, endeavors and alike amounts to the sum of the costs of expected damages (ED) and the costs of avoidance of these damages (CA);  $TC = ED + CA$ .

These damages can – as the concept of cost itself suggests – include everything related to it, be it the loss of credibility, lives, actual liabilities to be paid and so on.

Actors are supposed to ask themselves, how marginal changes in costs influence their actions; i.e. actors take marginal costs in consideration – marginal costs of expected damages (MED) and the marginal costs of avoidance (MCA) – first order derivatives from the respective costing curves;  $MED = ED'$  and  $MCA = CA'$ .

In a simple two dimensional system, let the ordinate (y) measure all costs and let the abscissa (x) be a measure of the degree of caution all actors must take. On the abscissa, two points are interesting. First, the optimal degree of caution as indicated by the outcome of the calculation made by actors especially in S1 economically defined as  $\min TC$ , or, O; i.e. the point in which total costs are minimized. Since ED is an increasing function and CA a decreasing one; O is a trade-off between both functions. The trade-off occurs at the point where the marginal cost of the expected damages and the marginal costs of avoidance equal each other; hence  $MED = MAC$  at  $\min TC$ , O.

State institutions, political entities and civil servants as agents will try to operate within the realms of O in which they know their total costs will be minimized and that at that point society as a market will allow them to operate. This corresponds to the absolute liability concept and hence to the S1 scenario.

For agents operating under the idea of tortious liability, for example in the S2 scenario, the formalization is importantly different. As long as they implement all measures to avoid damage, they only carry these costs, and not the costs of damage themselves, which is externalized to the state, hence in S2:  $TC = CA$ ; if  $TC < O$ . Due to contractual agreements



and social as well as political pressure, if they operate beyond the level of caution expected from the government; it means beyond O, they pay TC; this means, S2:  $TC = CA + ED$ ; if  $TC \geq O$ . This translates to their intention in maintaining  $CA > O = \min TC$ ; which is by definition less cost-intensive than the point at which political entities are prone to work. In this case, contractors in a S2 scenario will operate more cautiously than those in S1. Note that for S2 O is not an option either; even it being an social optimum, O is the point at which costs increase for S2; they increment by ED which was absent of S2 cost function before.

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