



11 Goodwin Street, London N4 3HQ
020-7281 0297 telephone
020-7281 4369 fax
email: enquiries@caat.org.uk
web: www.caat.org.uk

The case for withdrawing Government financial support from the Defence Export Services Organisation

1. The Campaign Against Arms Trade (CAAT) is working for the reduction and ultimate abolition of the international arms trade, together with progressive demilitarisation within arms-producing countries.
2. In this document, however, CAAT is leaving aside the moral and ethical arguments for shutting the Defence Export Services Organisation (DESO). There is also a strong case on economic and other grounds for withdrawing Government financial support. It is this that is addressed here.

An internationalised arms industry

3. When the Defence Sales Organisation (DSO), as DESO was then known, was set up by then Defence Secretary Denis Healey in 1966, there was an identifiable UK arms industry which existed primarily to supply the UK's own armed forces. A UK arms export would have been easily defined.
4. Today there is no identifiable UK arms industry. Military industry is internationalised with most equipment containing components and sub-systems from a variety of companies. The companies may have their headquarters in one country, but subsidiaries in several others.
5. BAE Systems illustrates this trend. It sells more to the US Department of Defense than it does to the UK Ministry of Defence (MoD), most of its shares are held outside the UK and less than a third of its workforce is employed in the UK. It would already be a US company had it been able to persuade one of the massive US companies to buy it. BAE Systems and the other major arms companies exist to maximise profits for their international shareholders and have little, or no, commitment to the UK and UK "defence".
6. Astonishingly, DESO has responded to this trend not by being more selective about which exports it supports, but by broadening its assistance. In 2005, this led CAAT to ask Alan Garwood, the Head of DESO, what determined whether or not his organisation would consider a particular export as being a UK one, and, as such, entitled to DESO support. The quote which follows, from Mr Garwood's response, is a lengthy one as it illustrates that the definition of an export worthy of DESO's, and by implication UK government and taxpayer, support is both wide and unclear.

7. Mr Garwood explained, in a letter dated 9th September 2005, that DESO takes its definition from the Defence Industrial Policy (DIP): "DIP defines UK defence industry broadly as embracing all defence suppliers that create value, employment, technology or intellectual assets in the UK. This includes both UK, multinational and foreign companies. DIP also recognises that UK-based firms have operations outside of the UK, which provides a route for technology and economic benefits flowing back into the UK. It thus defines UK defence industry in terms of: where the technology is created, where the skills and intellectual property reside, where jobs are created and sustained, and where the investment is made."
8. He continued: "The broad test for assessing DESO support to a UK-based defence exporter is not company ownership, but the added value that the export would bring to the UK defence industrial base. When assessing competing bids - including situations where one of the suppliers may be foreign-owned - employment, the quality of the work, and the transfer of technology to the UK will be key influences."
9. Swedish Gripen fighter aircraft have received DESO support as they "use some UK-manufactured components" and exports by the UK subsidiary of the US-based Lockheed Martin might also qualify.
10. CAAT appreciates that military exports are not unique in raising questions about the appropriateness of UK government support for a multi-national commercial enterprise. The Export Credits Guarantee Department (ECGD), for example, is holding a consultation on Foreign Content in which it proposes addressing the problem by a formula based on percentage terms.
11. In contrast to the approach of the ECGD, the "UK test" adopted by DESO seems noticeably vague. It is unclear how it was developed and is open to subjective decisions by DESO which, particularly if there are "competing bids", is left susceptible to lobbying.

No second-hand sales

12. A major part of DSO's work in the early days was to sell surplus UK armed forces equipment and through this, to make a return to the MoD. However, in April 2005, the Disposal Services Agency, which is responsible for this work, moved from DESO to become part of the Defence Logistics Organisation.
13. The need to recoup some MoD costs is, therefore, removed as a reason for continuing Government support for DESO.

A public subsidy for a private industry

14. DESO co-ordinates most of the direct government support for arms exports. It provides marketing assistance and advice on negotiation and financing arrangements, as well as organising arms exhibitions and promotional tours. The budget for DESO's net operating costs in 2006-7 is £15 million. (Hansard, 4.9.06) It employs around 450 staff in London and overseas, with over 200 working on Government-to-Government contracts and paid for by the customer governments.

15. As well as the actual assistance given by DESO, the arms companies value the position it gives them at the heart of government. The Head of DESO is always seconded from an arms company. DESO can argue a company's case against other departments, and through its explicit role of lobbying ministers is likely to distort policy making.
16. More recent examples will have to wait until, and if, the documents are released into the public domain. Historically, however, DSO /DESO persuaded more reluctant parts of government that military equipment should be sold to Saddam Hussein (Scott Inquiry Report, February 1996) and that the taxpayer should underwrite the Al Yamamah deals with Saudi Arabia. Documents obtained from the National Archive, and now on www.caat.org.uk, show that the Treasury, ECGD and the Bank of England were all unhappy with the financial arrangements for the latter.
17. The cost of DESO is a relatively minor component of what many studies have revealed to be a considerable subsidy afforded to arms exports. Other factors which contribute to the subsidy include export credits, research and development spending and assistance from military attachés. The studies include Stephen Martin's 'The subsidy saving from reducing UK arms exports', *Journal of Economic Studies*, 26:1 (1999) and the Oxford Research Group and Saferworld's *The Subsidy Trap: British Government Financial Support for Arms Exports and the Defence Industry* (July 2001).
18. Even the MoD has accepted that the economic picture is not as traditionally portrayed. In its Defence Industrial Strategy (December 2005) it says: "Arguments for supporting defence exports in terms of wider economic costs and benefits e.g the balance of payments, are sometimes also advanced. A group of independent and MoD economists (M Chalmers, N Davies, K Hartley and C Wilkinson - *The Economic Costs and Benefits of UK Defence Exports*. York University Centre for Defence Economics, 2001) examined these, by considering the implications of a 50% reduction in UK defence exports. They concluded that the "economic costs of reducing defence exports are relatively small and largely one off...as a consequence the balance of argument about defence exports should depend mainly on non-economic considerations."
19. Military exports undoubtedly bring commercial benefit to UK-based companies. This is not, however, the same as benefiting the UK economy as a whole. The taxpayer should not be in the business of subsidising private companies to help them boost their profits and share prices.

Arms trade employment

20. The UK Defence Statistics show that 65,000 jobs are sustained by military exports, just 0.2% of the national labour force. The MoD-York report, see above, concluded in 2001 that halving military exports over the two-year period from 1998/9 to 2001 would lead to the loss of almost 49,000 jobs, but that 67,400 jobs would be created in non-military sectors over the following five years.
21. The area with most jobs directly related to arms exports is the South East, which has virtually full employment. Where specific towns have a high concentration of arms export dependent jobs, government and community initiatives could create new training and employment opportunities for those whose jobs were affected. Past military redundancies have had the least negative impact when companies have worked in partnership with trade unions, local authorities and other agencies to assist

people to find alternative employment. In fact between 1995 and 2004, jobs dependent on military exports fell from 145,000 to the present level of around 65,000 with no major impact on the economy.

22. The arms companies are, not unnaturally, prone to exaggerate the number of jobs sustained by the arms industry. For example, in the run-up to the decision to stop the Serious Fraud Office inquiry into the BAE Systems Al Yamamah deal with Saudi Arabia, figures of up to 50,000 jobs under threat were appearing in the press. However, a report commissioned by the Eurofighter PR and Communications Office and published on 16th June 2006, entitled *The Industrial and Economic Benefits of the Eurofighter Typhoon* and written by Professor Keith Hartley of the Centre for Defence Economics at the University of York, says that the Eurofighter deal with Saudi Arabia would secure around 11,000 jobs throughout the whole of Europe. This would mean less than 5,000 jobs located in the UK and, even then, it does not include the impact of promised offsets for Saudi Arabia. BAE Systems' Finance Director George Rose has said that his company wants to establish indigenous capability there. (Jane's Defence Industry, April 2007)
23. The hundreds of millions of pounds saved by reducing or ending the UK arms trade could be invested in other industries such as renewable energy and transport, which would create new, highly skilled jobs. As well as being more sustainable, this would be likely to be a far more popular use of public funds than supporting the arms industry.

Government and UK reputation at risk

24. According to Transparency International, military industry ranks alongside construction as the world's most corrupt sector. The close ties with and public support given to military companies by DESO risks tainting the Government with allegations of corruption.
25. There is an institutional history of this. Back in the late 1960's and early 1970's there was corruption in UK arms sales to Saudi Arabia, and that this was known about by DSO officials who turned a blind eye. (National Archive records) Recently, before it dropped the probe into Al Yamamah, the Serious Fraud Office (SFO) interviewed Alan Garwood under caution. The SFO is understood to have asked him whether DESO knew if payments made to Saudi officials continued after 2001, when the law was changed making payments which could be construed as bribes illegal. (Daily Telegraph, 8.3.07)
26. The close relationship between the Government and the arms companies, facilitated by DESO, can also compromise the UK's reputation in other ways. For example, fund managers, worried about London's standing as a financial centre, questioned the decision to end the SFO inquiry. In a letter sent to Tony Blair, Hermes said: "Lack of credibility in the regulation of one company can spread to the rest of the stock market, creating higher-risk premiums and cost of capital." F&C Asset Management writing to Defence Procurement Minister Lord Drayson said: "As a long-standing advocate of strong corporate governance and anti-corruption standards, we place great value on the actions that governments take to ensure the investment climate is marked by clear, predictable standards and independent enforcement of the rule of law." (Sunday Times, 24.12.06)

27. In June 2007, Reed Elsevier plc, announced that it was selling its arms exhibition business. This had included organising the Defence Systems and Equipment International exhibition on behalf of DESO. The Reed Elsevier decision came following complaints from customers, shareholders and those writing for its academic publication. The reputation of a major company was being damaged because of its links with military industry.

UK security

28. Military exports are often justified as a way of ensuring continuity in production so that the UK's own armed forces can be supplied when needed. However, the exports can take precedence. For example, the first 24 Eurofighter planes for Saudi Arabia will be taken from those originally destined for the RAF.
29. Exports can also influence purchases for the UK's armed services. In 2003 the RAF bought BAE Systems Hawk trainer aircraft without the open competition favoured by the Defence Procurement Agency. Furthermore, The Treasury did not believe the Hawks offered value for money. However, not all within the MoD opposed the choice. Lord Bach, the Defence Procurement Minister, saw the RAF's purchase as an opportunity to push exports. (Sunday Times, 18.5.03 & 3.8.03) This was reinforced when the then BAE Systems Chair, Sir Richard Evans, told the Commons' Defence Committee on 5th May 2004 that, had the RAF not bought the Hawks, his company would have been unable to complete a deal to sell the aircraft to India.

Use of UK armed forces

30. DESO's Senior Military Advisor told the DESO Symposium in March 2007 of visits to Service Chiefs whose "faces always fall when we arrive, because they know we are on the scrounge." He spoke of the 28 soldiers of the Export Support Team who will do in-country training on exported kit; the Defence Industry Days on Royal Navy ships; and the negotiation for the deployment of RAF planes to help specific export campaigns. He gave the example of the Eurofighter Typhoon going to Singapore. There are charges, he told his industry audience, but DESO's time and effort in arranging for it was met by the taxpayer.

Diplomacy

31. Another reason often advanced for public support for military exports is "defence diplomacy". Again, the Saudi Arabia case exposes the fallacy of this. For all the UK government's desire to expand its influence around the world, the dropping of the SFO inquiry shows very clearly where the real power lies, with the customer government and the supplier company.
32. A high proportion of DESO staff are paid for by the customer governments of Saudi Arabia and, to a much lesser extent, Kuwait. In May 2006, the Saudi Armed Forces Project employed 111 staff in the UK and 62 in Saudi Arabia. (Hansard, 22.5.07) This would seem anomalous - UK civil servants being paid for by overseas governments to support contracts profiting private companies.

July 2007