

BAE Systems in 2005

Business overview

BAE Systems is one of the world's largest arms producers and exporters. Satisfied customers include the autocratic Saudi regime, one of the most extreme abusers of human rights in the world; the militarily aggressive US administration; conflict-ridden Indonesia and Israel; and heavily indebted Tanzania. All of this is highly profitable for BAE Systems. In 2005, 79 per cent of its £15.4 billion worth of total sales came from its military products. This focus on the military will increase further during 2006 and may become almost exclusive given the sale of its civil aerostructures businesses and the stated desire to dispose of its stake in Airbus.

BAE System's key areas of operations have continued to thrive in 2005. It remains so close to the government as to be, at times, inseparable. The MoD and BAE Systems came up with a new Defence Industrial Strategy that guaranteed BAE Systems massive UK military contracts without having to bid for

them. This despite the abject failure of BAE Systems to keep to cost or schedule on previous projects. It has played down and avoided comment on corruption allegations despite ongoing Serious Fraud Office investigations. It has sold arms to 130 countries and, with the enthusiastic help of ministers including Tony Blair, secured a new, massive deal with Saudi Arabia. Last, but certainly not least, it has made a further significant move towards the US with the purchase of United Defense, the combat vehicles and munitions manufacturer.

Outlook – Despite the UK MoD granting BAE Systems virtual monopoly status and the tax-payer sourced profits that this will bring, the future for BAE Systems appears to be in the US and purely military. The result is likely to be profitable for BAE Systems and its shareholders but costly for tax-payers in the UK, US and around the world, and deadly for those who find themselves on the receiving end of its array of weaponry.

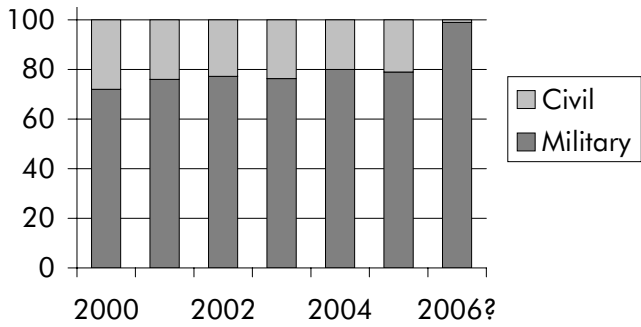
“New threats and conflict arenas are placing unprecedented demands on military forces and presenting BAE Systems with new challenges and opportunities...”

BAE Systems Annual Report 2005

BAE Systems at a glance

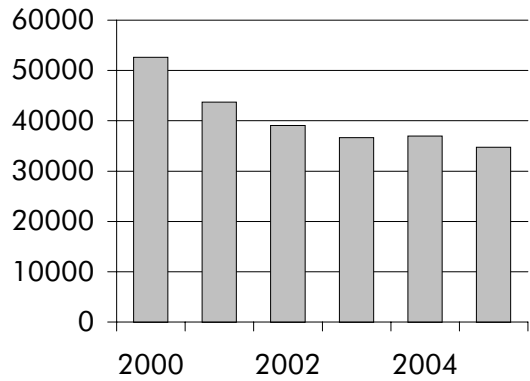
Military and civil sales¹

Source of Revenue, %

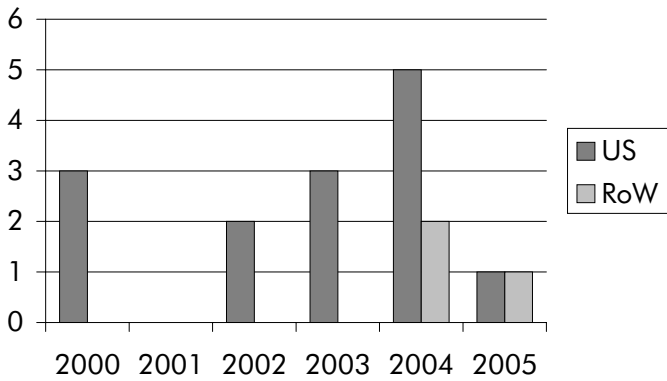


Employment²

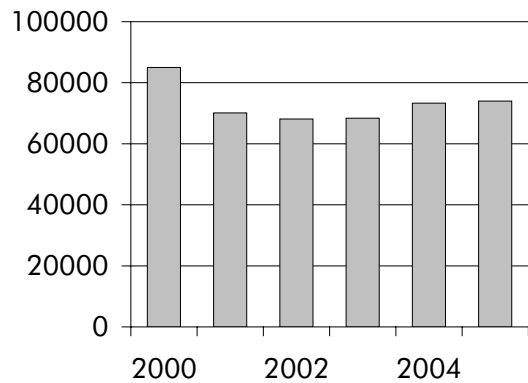
UK Employment



Acquisitions³



Worldwide Employment



“We owe a great deal to John Reid (the Defence Secretary) and Lord Drayson (the Defence Procurement Minister)”

Mike Turner, BAE Systems Chief Executive⁵

Review of operations

Climbing into bed with the government

BAE Systems has transcended the world of lobbying when it comes to influencing the UK government. It is extremely close to Tony Blair (In his 2003 autobiography Robin Cook observed “I never once knew number 10 come up with any decision that would be incommensurate to British Aerospace”⁴), has become an integral part of the MoD, spins the revolving door to give jobs to influential political and military figures, and has BAE Systems employees on a wide array of high-level quangos. No stone is left unturned in the company’s mission to control the MoD’s procurement budget and influence ‘defence’ and arms export policy.

Probably the most blatant influence is provided through the Defence Export Services Organisation. DESO employs nearly 500 civil servants within the MoD to sell arms for companies and to lobby for arms exports within government. Since 2002 it has been headed by Alan Garwood, a secondee from a BAE Systems company. Part of this formal role is to advise government ministers on arms exports, and a previous BAE Systems Head of DESO stated that he enjoyed “direct access to Major and Blair”. With BAE Systems being the main exporter of arms from the UK, and completely dominant in terms of arms industry politics, DESO is virtually a tax-payer funded lobbying and sales department for BAE Systems. Most strikingly, 200 of DESO’s 500 staff work in Saudi Arabia on a BAE Systems run project.

Plundering the public purse

BAE Systems has had its own way with MoD procurement, not least getting the tax-payer to pay for the company's mistakes or persuading the MoD to purchase equipment that it hadn't decided it wanted or that was outdated and irrelevant to its needs.

But despite consistently failing to deliver military equipment procured by the MoD on time and on budget, it continues to receive tax-payer bail-outs and new contracts. During 2003, BAE Systems or its associated companies were responsible for four projects that collectively accounted for a £2.7 billion cost overrun and were delayed by 113 months.⁷ But these can't compare with BAE Systems' record on the Eurofighter Typhoon.

During the early 1980s, a common European requirement for a new generation of aircraft was identified to defend against massive air attacks from the communist block. In response the predecessors of EADS based in Germany and Spain, Alenia Aerospazio based in Italy, and BAE Systems developed the Eurofighter, a plane designed to specialise in dog-fighting Soviet fighters. The plane has cost the UK alone more than £19 billion,⁸ £12 billion more than initially projected.⁹ That is about £350 for every adult and child living in the UK, the equivalent of paying £1.1 million for every job that the project is said to sustain. The Eurofighter Typhoon has taken thirty years to make and became operational ten years later than first anticipated. Even as long ago as 1997, Alan Clark, former Minister of State for Defence, remarked that the Eurofighter was "essentially flawed and out of date ... we must find a less extravagant way of paying people to make buckets with holes in them".¹⁰

Defence Industrial Strategy/stitch-up

BAE Systems' hold over the UK government couldn't be better illustrated than by the MoD's December 2005 Defence Industrial Strategy. This was presented by the Minister for Defence Procurement, Lord Drayson, (presumably with his tongue firmly in his cheek) as a "tough partnership. It is about BAE delivering improved performance in return for longer term business with us."¹¹ Mike Turner described his attempts in "persuading the Ministry of Defence that it had to change our terms of trade, and as part of that, the Defence Industrial Strategy" as one of the most important business events in his life. He was able to say, "we have got what we asked for". There is no doubt they did. The Defence Industrial Strategy identifies industrial partners covering "key industrial capabilities" who will basically receive MoD contracts without having to bid competitively. These key areas conveniently cover BAE Systems' areas of interest.

Arms export subsidies

It is not only MoD procurement that provides BAE Systems with ready access to tax-payer money. Along with other UK-based arms exporting companies, it continues to be the beneficiary of a rolling programme of both financial and political support for its exports. The range of support includes DESO, of course, but also export credit guarantee provision, favourable procurement choices and marketing support including the use of ministers, MoD personnel and the royal family to promote sales abroad. Research puts the net costs to the UK taxpayer at between £228 million and £990 million every year.

"we have got what we asked for"
Mike Turner on the Defence Industrial Strategy⁶

“During 2005 the Serious Fraud Office and Ministry of Defence Police continued their investigation in to the Company and certain employees in relation to allegations of false accounting and corruption” BAE Systems Corporate Responsibility Report 2005

Fielding corruption allegations

The Serious Fraud Office (SFO) investigation surrounding contracts between BAE Systems, Robert Lee International Ltd and Travellers World Ltd in relation to arms deals with Saudi Arabia continued during 2005. The investigation started in November 2004 following allegations, printed in the *Guardian* and followed up by the BBC, that BAE Systems had run a £60 million “slush fund” for the benefit of members of the Saudi ruling family. A number of arrests were made, including that of Peter Wilson, BAE Systems’ Managing Director of International Programmes, who reportedly had been in charge of the Al-Yamamah programme in the past. Those arrested were released without charge after questioning.¹²

2005 saw the widening of the SFO investigation to include alleged payments between 1997 and 2004 to offshore companies linked to General Pinochet, the former Chilean dictator. In September the *Guardian* reported that US banking records allegedly showed that BAE Systems had secretly paid £1 million to General Pinochet in return for help over arms deals. The paper stated that SFO and MoD police investigators had flown to Chile to investigate the claims and reported that the Foreign Office had confirmed that a SFO team had met a judge in Santiago.¹³

There is also plenty of scope for further investigations and potential financial liabilities for BAE Systems, not

least with regard to Indonesia. When a former Alvis (now owned by BAE Systems) agent sued the company over the sale of tanks and armoured personnel carriers to Indonesia, the court papers provided a rare public window into the murky world of the arms trade.¹⁴ The information raised questions regarding the activities of a number of other companies including Royal Ordnance.

The plethora of questions and allegations should not be surprising given that, according to Transparency International the official arms trade “accounts for 50% of all corrupt international transactions”.

BAE Systems traditionally provides no specific comment in response to allegations but does issue bland public relations statements along the lines of that in this year’s Corporate Responsibility Report, “we believe we meet the highest ethical standards in our dealings with others and that we have the processes in place to ensure our employees comply with these standards and the law in all the countries where we operate”.

However, BAE Systems’ real standards are clearly indicated by its response to the Export Credits Guarantee Department’s anti-bribery procedures. During 2004 BAE Systems lobbied and successfully diluted the procedures. When the government was forced to carry out a wider consultation, BAE Systems continued its lobbying, focusing on keeping the ECGD from knowing the identity of agents, even though agents are often the conduit for bribes.

Selling arms around the world

Saudi Arabia

It was one of BAE Systems' traditional markets that presented the company with its red-letter arms deal in 2005. In December, the Ministry of Defence announced that a Memorandum of Understanding had been signed between the Saudi and UK governments paving the way for the latest massive transfer of BAE Systems' arms to Saudi Arabia: billions of pounds worth of Eurofighter Typhoon aircraft.¹⁵

Since the 1980s, British Aerospace-BAE Systems has been responsible for managing the Al Yamamah deal, the largest UK military export package in history. BAE Systems Chief Executive, Mike Turner, revealed in 2005 that the total Al Yamamah package has been worth £43 billion over the last 20 years.¹⁶ There were 4,600 BAE Systems employees in the country in 2005. In Saudi Arabia there are no political parties, no freedom of association, no freedom of expression, no trade unions and no independent local media. Women are denied the vote, the chance to stand for election and face severe restrictions on movement. Harsh repression of all forms of opposition is commonplace. There is ongoing concern over allegations of torture and mistreatment of prisoners. Amnesty International describes the overall human rights situation in the country as "dire". Even the Foreign Office remain concerned about "the implementation of basic international human rights norms". The continued export of high-profile military equipment to a government with an appalling record on human rights does nothing to persuade the Saudi monarchy to address these concerns. It rewards the activities of a brutal regime.

Israel

Israel's military occupation of the Palestinian territories has fuelled a conflict in which thousands have been killed. F-16 aircraft have been widely reported as being used by the Israeli Defence Force to attack Palestinian civilian areas. BAE Systems is a supplier of sub-systems for the US F-16s that are currently being delivered to Israel.¹⁷

BAE Systems also has a number of business relationships with Israeli arms companies including, through MBDA, working on 'Ballistic Missile Defense' with Israel Aircraft Industries.¹⁸ Though BAE Systems attempts to distance itself from cluster bombs, it has received MoD contracts for L20 cluster shells (the type used by the UK armed forces in the battle for Basra), the manufacture of which has been sub-contracted to Israel Military Industries.¹⁹

Indonesia

2005 saw the first full year of BAE Systems' ownership of Alvis, and thus the military vehicle businesses of Vickers and GKN. Throughout the conflicts and repression in East Timor, Aceh and West Papua, UK companies have been a major supplier of arms to the Indonesian military, providing more than half of their military equipment over the past ten years. Arms sold have included Scorpion light tanks, Tactica and Stormer armoured personnel carriers, Hawk 109 fighter trainers with combat capability and Hawk 209 light combat aircraft. All of this equipment is now within BAE Systems' portfolio, and will be supplied with BAE Systems spares to keep it operational.

South Africa

In 1999 the South African government signed a £3-£4 billion arms package that included 24 BAE Systems Hawks and 28 BAE Systems/SAAB Gripen fighters, a deal grossly disproportionate and inappropriate to the actual needs of the country, both strategically and in terms of its economic and social development. The BAE Systems Annual Report states that the Hawk export contract progressed during the year and that the first Gripen for South Africa flew in November 2005.

2005 also saw the release of drafts of a 2001 official investigation into the South African arms deals. Recommendations from a committee of defence and finance ministry officials included in the draft concluded that there was no military rationale for

buying the Gripen fighters. The draft report also said "There were fundamental flaws in the selection of BAE-Saab as the preferred bidder". Neither of these statements appeared in the final draft.²⁰

India

Following intense ministerial lobbying of the Indian government, which continued even as India and Pakistan were on the brink of war, BAE Systems secured the Hawk fighter trainer deal in 2003. 2005 saw "significant progress" on the export contract but also reports throwing new light on the potential use of these 66 aircraft. Though there has been much talk of their use purely as training aircraft and their similarity to the RAF's unarmed Hawk trainers, the Indian Hawks will be able to carry weapons. Jane's Defence Weekly revealed that the Hawk contract makes "special

provision for weapons integration, including a gun"²¹ and the Times of India quoted the head of the Indian Air Force as saying it would use the Hawk as "a combat aircraft should an operational scenario present itself".²² BAE Systems has, according to its Annual Report, a "growing relationship with India", including MBDA obtaining an order for Exocet anti ship weapons during the year. Saab, another BAE Systems "partnership", signed a provisional contract to supply airborne surveillance systems to Pakistan.

"With major operations on 5 continents and defence customers in some 130 nations, BAE Systems is well placed to use its strong UK and enhanced US presence as a springboard for further growth in both new and established defence markets"

BAE Systems Annual Report 2005

“if you look at it from pure shareholder returns; you’d be in the US, wouldn’t you”
Mike Turner, February 2005²³

Searching out the Bush \$

The US has increased its military spending by an average of 10 per cent per year in real terms since 2001 and now accounts for nearly half of global military spending. While the spending covers military equipment, personnel and the infrastructure of over 700 military bases in around 130 countries, much of the increase is accounted for by the invasion and occupation of Iraq and, to a lesser extent, Afghanistan.

The scale of the US’s military spending makes it an irresistible draw for BAE Systems. In the recent past they have tried to merge with major US companies, but have had their approaches rebuffed. The default strategy is to gradually buy their way into the market by acquiring US companies. June 2005 saw a massive step in this direction with the £2.2 billion purchase of United Defense, the manufacturer of combat vehicles, naval guns, missile launchers and munitions.

United Defense will form part of a new international land systems business alongside BAE Systems’ existing UK, South African and Swedish “Land and Armaments” businesses and will be headquartered in the US. That it has chosen to do this, despite it being the supplier of 95% of the UK MoD’s armoured fighting vehicles, indicates where its priorities lie. It is certainly well positioned to take further advantage of the increased US ground fighting following the Iraq and Afghanistan invasions.

In 2005 BAE Systems ranked seventh in terms of sales to the Pentagon, supplying a vast range of equipment from artillery to thermal weapons sights. They are likely only to increase their US deals and climb the Pentagon ranking.

Endnotes

- 1 2000-04 figures taken from *Defense News*, 2005 from Corporate Responsibility Report 2005, 2006 is as for 2005 but assuming the sale of BAE Systems’ Airbus stake
- 2 Total employment is taken from BAE Systems’ 2004 and 2005 Annual Reports and does not include a share of joint ventures. UK employment is from Corporate Responsibility Reports 2000-2005
- 3 BAE Systems Annual Reports 2001-2005. “RoW” refers to Rest of the World
- 4 Robin Cook, *The Point of Departure*, Simon & Schuster, London 2003
- 5 *Times*, 27 February 2006. business.timesonline.co.uk/article/0,,9067-2059728,00.html
- 6 *Times*, 27 February 2006
- 7 National Audit Office Press Notice, *Ministry of Defence: Major Projects Report 2003*, 23 January 2004. www.nao.org.uk
- 8 National Audit Office, *Ministry of Defence: Major Projects Report 2004: Project Summary Sheets*, p.113
- 9 Susan Willett, Eurofighter: White Heat of Technology or White Elephant? *International Security Information Service*, Briefing No. 64, October 1997.
- 10 *Hansard*, 9 July 1997, Col. 855. www.parliament.uk/index.cfm
- 11 House of Commons Defence Select Committee, 28 February 2006, uncorrected evidence, www.publications.parliament.uk/pa/cm200506/cmselect/cmdfence/uc824-iii/uc82402.htm
- 12 *Guardian*, 14 September & 24 November 2005
- 13 *Guardian*, 16 & 29 September 2005
- 14 see www.guardian.co.uk/armstrade/subsection/0,,1369361,00.html
- 15 Ministry of Defence, Press Notice-UK-Saudi Arabia deal to modernise the Saudi Armed Forces, 21 December 2005. www.mod.uk
- 16 *Flight International*, 21 June 2005
- 17 *Airforces Monthly*, June 2004
- 18 Israel Aircraft Industries website, news item, 22 July 2004, www.iai.co.il
- 19 *Hansard* 14 April 2003 Col. 566w, *Hansard* 17 November 2003 Col. 497w
- 20 *Telegraph*, 8 January 2005
- 21 *Jane’s Defence Weekly*, 8 June 2005
- 22 *Times of India*, 26 May 2005
- 23 *Financial Times*, 24 February 2005