

SIPRI assessment of UK arms export subsidies  
For CAAT  
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The aim of this paper is to provide an updated assessment of UK arms export subsidies for CAAT. The paper covers 2007-2010 and provides figures (where available) as well as a brief description of the debate around these subsidies and the basic elements of the calculation (or estimate when a calculation is not possible). As with military spending more generally, it is difficult to calculate arms export subsidies from spending on other objectives that have military and/or foreign policy implications. One example Ingram and Isbister (2004: 22) give is that foreign military assistance and training can be motivated by a variety of factors including “strengthening military capability of allies, security sector reform, strengthening strategic and diplomatic ties, or simply encouraging the sale of British equipment.” For this reason, the final section of this paper is devoted to potential issues involving problem areas such as data availability, methodology and conceptualisation.

This assessment is based on open source material. ‘Arms’ is used here interchangeably with ‘weapons’ and both terms are meant to cover military specific exports including services such as training.

### **Types of subsidies**

In *Escaping the Subsidy Trap*, Ingram and Isbister have identified three broad categories of arms export subsidies:

- Direct assistance
- Export credits
- MoD’s procurement policy

These categories can include:

- DSO
- Military attachés
- Use of armed forces for promotion
- DAF
- Export credits
- MoD procurement distortion
- Official visits
- Missile Defence Centre
- Savings in overhead
- Development

For the arms export subsidy calculation presented here, this paper incorporates all the subsidies listed except for overhead savings (which is dealt with in the Issues section). The paper also provides a separate figure for development.

**Table 1: UK arms export subsidies (2007-2010)**

<b>Subsidy type</b>	<b>2007/08</b>	<b>2008/09</b>	<b>2009/10</b>
<b>DESO/DSO</b>	12.6	14.6	15.8
<b>Military attaches</b>	21.2	19.4	20.0
<b>Use of armed forces</b>	5.3	5.3	5.3
<b>DAF</b>	5.0	5.0	5.0
<b>Official visits</b>	5.0	5.0	5.0
<b>Missile Defence Centre</b>	5.0	5.0	5.0
<b>Direct distortion</b>	5.0	5.0	5.0
<b>ECGD</b>	90.2	46.7	75.4
<b>Sub-total</b>	149.2	105.9	136.5
<b>Development**</b>	602.0	562.4	562.4
<b>Grand total</b>	751.2	668.3	698.9

\*\* Note: Ingram and Isbister acknowledge that R&D is a substantial subsidy for the arms industry. However, because of the controversial nature of this subsidy and the ability to apply it to arms exports in particular, R&D (in particular the development portion) is provided separately.

### **Breakdown of the subsidies**

#### Defence and Security Organisation (DSO)

The DSO was established in 2008 after the MoD's DESO was folded into UK Trade and Investment (UKTI). The organisation's aim is to assist UK arms producers and security companies to export.<sup>1</sup> Its services include

- working with industry to “build and maintain relationships with overseas customers, providing the essential government-to-government interaction” and
- providing after-sales support and export advice and practical assistance by working closely with the MoD and with other departments and agencies.

The DSO's regional offices are the first point of contact between British arms producers and military services companies and overseas customers. In addition, the DSO's Business Development Directorate manages events and exhibitions and provides market analysis and support for SMEs. The regional directorates have experts working with the security industry promoting UK Security Industry Marketing Strategy.<sup>2</sup>

<sup>1</sup> UK Trade and Investment Ministry. ‘About UKTI DSO.’ 12 May 2010. <<http://www.ukti.gov.uk/defencesecurity/aboutuktidso.html>>.

<sup>2</sup> UK Parliament. ‘Arms Trade: Exports.’ *Daily Hansard—Written Answers*. 19 October 2010. <<http://www.publications.parliament.uk/pa/cm201011/cmhansrd/cm101019/text/101019w0004.htm>>.

DSO's annual net operating costs are provided in Parliament's *Official Report* in response to requests.<sup>3</sup>

### Military attachés and embassies

A portion of military attachés' time is devoted to promoting arms exports. There are various figures concerning just how much time. Des Browne estimated that they spend 5 percent of their time on arms exports.<sup>4</sup> This figure seems rather low, though, considering a 1989 National Audit Office report estimated military attachés spend 40 percent of their time on direct and indirect arms export promotion. As pointed out by CAAT, a buyers' market is likely to lead to more British arms export promotion than less.<sup>5</sup> With the global economic downturn continuing and pressure to decrease national military expenditures, it is likely arms export promotion is still considered important and on the higher side of what military attachés do.

Beginning 1 April 2008, the FCO began charging the MoD for administrative and accommodation costs incurred by the FCO for the military attachés. Over a three-year transitional phase, the MoD agreed to pay annually the FCO a fixed amount to compensate for these costs.<sup>6</sup> Prior to 2008, the FCO did not maintain separate cost lines and cannot provide what it spent on military attachés; however, the FCO has estimated that it spent £15 million in 2007-08 on costs incurred for military attachés.<sup>7</sup>

Looking at financial year 2006-2007 and comparing the MoD reported expenditures for military attachés (£38.7 million) with the estimated cost the FCO spent in that year (£10 million), previous estimates have likely under-estimated the costs of military attachés by only having the MoD figure included in the subsidy calculation.<sup>8</sup>

The calculation presented here uses the higher estimate (40 percent) for the time military attachés spend because it is a buyers' market and the UK government seems to be working hard to export arms. The calculation is based on the combined FCO and MoD amounts. The latter figure is estimated based on the amount the MoD paid for military attachés in financial year 2006/07 and what was budgeted for financial year 2010/11, the two financial years for which data is available.

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<sup>3</sup> For 2007-08: UK Parliament. 'Defence Export Services Organisation: Finance.' *Daily Hansard—Written Answers*. 16 June 2008. <<http://www.publications.parliament.uk/pa/cm200708/cmhansrd/cm080616/text/80616w0003.htm>>; for 2008-09: UK Parliament. 'UKTI DSO.' *Daily Hansard—Written Answers*. 10 June 2010. <<http://www.publications.parliament.uk/pa/cm201011/cmhansrd/cm100610/text/100610w0007.htm>>; for 2009-10: UK Parliament. 'Arms Trade: Exports.' *Daily Hansard—Written Answers*. 19 October 2010. <<http://www.publications.parliament.uk/pa/cm201011/cmhansrd/cm101019/text/101019w0004.htm>>.

<sup>4</sup> UK Parliament, Select Committee on Defence. 'Examination of Witnesses: Des Browne.' *Minutes of Evidence*. 17 January 2008. <<http://www.publications.parliament.uk/pa/cm200708/cmselect/cmdfence/254/8011703.htm>>.

<sup>5</sup> Campaign Against Arms Trade (CAAT). 'Arms Trade Subsidies Factsheet.' May 2004. <<http://www.caat.org.uk/resources/publications/economics/subsidies-factsheet-0504.php>>.

<sup>6</sup> They agreed to £10.5 million for 2008-09 and £15 million for 2009-10 and 2010-11. The figures provided by the FCO do not include the British Defence Section in Washington, DC nor costs related to operational expenditures for the British presence in Afghanistan and Iraq; see, UK Parliament. 'Armed Forces: Military Diplomacy.' *Lords Hansard—Written Answers*. 1 November 2010. <<http://services.parliament.uk/hansard/Lords/ByDate/20101101/writtenanswers/part004.html>>.

<sup>7</sup> UK Parliament (note 6).

<sup>8</sup> For 2006-07: UK Parliament. 'Military Attaches.' *Daily Hansard—Written Answers*. 23 July 2007. <<http://www.publications.parliament.uk/pa/cm200607/cmhansrd/cm070723/text/70723w0009.htm>>.

### Use of armed forces

The Export Support Team of the UK armed forces is used to promote arms exports. Due to the lack of recent data, the figures used in this paper are based on estimates derived from earlier years. The latest cost data available is an estimate for 2006-07 of £1.45 million. Net operating costs for 2004-05 were £2 million and for 2005-06 £1.75 million. The main reason for the decline was due to the decision to combine two teams into one.<sup>9</sup> Even with the decrease in personnel, though, it is expected that the cost of transporting the equipment used in demonstrations by the Export Support Team is much higher than the personnel costs.<sup>10</sup> To account for this discrepancy, the amount for 2005-06 has £3.5 million added to it, resulting in a total of £5.25 million. This figure is used for each of the subsequent financial years in this report since more recent official figures are not available. These services are now deemed as chargeable, though how much can be recovered by UKTI is unknown.<sup>11</sup>

### Defence Assistance Fund

The Defence Assistance Fund (DAF) is “available to subsidise the cost of defence assistance conducted either in UK or in-country, to support Defence Diplomacy activities. In this respect the DAF is used to defray the cost, in full or in part, of military assistance and training activities.”<sup>12</sup> The most recent figures for the amount the fund spent on supporting arms exports is for 2004-05 at £4.7 million. The average for the four financial years (2001-02 to 2004-05) for which the data is available is £5 million per year in arms export support from DAF. This amount was applied for the DAF arms export subsidy in this calculation though it is likely an under-estimate given the climate in more recent years and the average for the most recent four-year period would be higher.

### Official visits

Civilian and military officials visiting foreign countries regularly include military sales as a key talking point while traveling. Indeed, they often include representatives from their arms industry to attend these visits with them. For instance, David Cameron recently traveled to the Middle East, taking with him executives from the British arms industry in spite of the unrest and tensions in the region.<sup>13</sup> These types of visits cost taxpayer money in the name of promoting weapons sales. It is uncertain how much these trips cost and since they are often not solely about weapons sales, only a portion of the cost would be considered an arms export subsidy. That said, these visits do happen and can be very expensive especially the higher ranking the official. The calculation here uses previous estimates of £5 million per year.

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<sup>9</sup> UK Parliament. ‘Export Support Team.’ *Daily Hansard—Written Answers*. 20 October 2005. <<http://www.publications.parliament.uk/pa/cm200506/cmhansrd/vo051020/text/51020w25.htm>>.

<sup>10</sup> CAAT (note 5).

<sup>11</sup> UK Trade and Investment Ministry. ‘UKTI DSO Military Support.’ 1 July 2010. <<http://www.ukti.gov.uk/defencesecurity/defence/dsopartnerupdates.html>>.

<sup>12</sup> UK MoD, *Defence Diplomacy*. The Ministry of Defence Policy Papers. Paper No. 1. (nd). p. 3.

<sup>13</sup> Watt, Nicholas. ‘David Cameron hits out at Critics of Britain’s Arms Trade.’ *The Guardian*. 22 February 2011. <<http://www.guardian.co.uk/politics/2011/feb/22/david-cameron-britain-arms-trade>>.

### Direct distortion of MoD procurement choices

Procurement choices end up acting as a subsidy when weapons purchases are justified on the grounds of industrial and economic policy rather than in terms of military and security interests. This distortion became more evident in the post-cold war era. A round figure of £5 million per year is used here.

### UK Missile Defence Centre

Launched in 2003, the UK Missile Defence Centre's objectives are "to provide technical and scientific input to UK policy considerations, develop relationships between UK industry, the US Department of Defense (DoD) and industrial partners and support UK industry in the pursuit of commercial opportunities in the missile defence domain."<sup>14</sup> As the lead contractor for the centre, BAE Systems has received £3 million annually to manage the industrial interests in the Centre. BAE Systems currently holds the contract until 2011 though there are several other leading UK arms producers involved as partners. The average amount allocated annually for the Centre is approximately £5 million.

### Export credits

In general the Export Credits Guarantee Department (ECGD), according to Secretary Davey (Secretary of State for Business, Innovation and Skills), "engages directly with exporters, exporter representative bodies and banks that provide export finance to raise awareness of its services and products. ECGD also markets its facilities overseas so that projects sponsors and buyers are aware of the availability of export finance to assist the purchase of supplies from the UK."<sup>15</sup>

There has been a significant decrease in the ECGD support to military-related exports in the last two reporting periods with only 1 percent of ECGD support going toward arms export supports.<sup>16</sup> Instead, export support for civilian Airbus increased substantially (from 29 percent of ECGD's guarantees in 2007-08 to 89 percent in 2009-10). ECGD states these changes are a result of the impact of the global economic recession on bank lending capacity, among other things.<sup>17</sup> Total liability for ECGD has declined in recent years.

In addition, the annual reports no longer provide an at-risk figure broken down by sector, therefore it is unknown how much of the ECGD's total liability is for arms exports. The last year for which this figure is available is 2004-05 in which military-related business exposure was noted to be 26 percent of total liability.<sup>18</sup> Also included in the Ingram/Isbister calculation is Fixed Rate Export Finance (FREF). The annual reports for 2007-10 do not seem to have the necessary components from which to make the calculation (i.e., income and expenditure resulting from the FREF scheme). Plus, it is difficult to make a comparison with the earlier annual reports because they are unavailable electronically. It does seem that the reporting requirements have

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<sup>14</sup> BAE Systems. 'MDC: The UK Missile Defence Centre.' 7 August 2008. <[http://www.baesystems.com/WorldwideLocations/UnitedKingdom/UKDefenceIndustrialStrategy/Casestudies/autoGen\\_10809171112.html](http://www.baesystems.com/WorldwideLocations/UnitedKingdom/UKDefenceIndustrialStrategy/Casestudies/autoGen_10809171112.html)>.

<sup>15</sup> UK Parliament. 'Export Credits Guarantee Department.' *Daily Hansard—Written Answers*. 29 November 2010. <<http://www.publications.parliament.uk/pa/cm201011/cmhansrd/cm101129/text/101129w0005.htm>>.

<sup>16</sup> Export Credits Guarantee Department (ECGD). *Annual Review and Resource Accounts 2009-10*. London: ECGD. p. 18.

<sup>17</sup> ECGD. (Note 16). p. 19.

<sup>18</sup> ECGD. *Annual Review and Resource Accounts 2004-05*. London: ECGD. p. 12.

changed. For these reasons, the ECGD figures calculated here might not be comparable to earlier calculations.

The ECGD calculation here assumes that the share of arms export supports remained at 26 percent for the years since 2005 until 2008 because annual liabilities for arms exports remained fairly consistent for those years. Because of the significant decrease in these types of supports in more recent years, for the remaining years, the military share is calculated at 13 percent. This amount is based on the assumption that for the two years in which the annual share of arms export support dropped to 1 percent, the overall burden of arms support in the total liability did not drop to less than half of the 26 percent share in just two years. Indeed, depending on the terms negotiated in the credits, it is possible this figure was much more stable. This amount was multiplied by sovereign risk plus contract risk. The sovereign risk percent is based on the average of the basis points for 10-year sovereign bonds for Greece, Ireland and Portugal in 2007, 2008 and 2009, three of the most volatile bond markets in the European Union in those years.<sup>19</sup> The contract risk was estimated at 1 percent as in previous calculations. The calculation presented here does not include anything for FREF, which could result in a significant underestimate in the final ECGD arms export subsidy.

#### Development

At issue is the extent to which arms exports are a result of development assistance to the arms industry. Because it is obvious that a portion of exported arms stem from development, some of the money spent on that development might be recouped by the export sales. Another aspect of the debate is that development is likely to have been provided whether or not there were (anticipated) export sales.

The figure for development presented here covers total net expenditures on development, which includes intra- and extra-mural development costs to the UK MoD while accounting for receipts. The amount for 2009/10 is an estimate since the data for that financial year is not yet available.

In order to derive the share of development going to arms exports, previous calculations applied to the development figure the amount of UK arms exported annually as a share of total UK arms sales, using MoD figures on annual arms purchases. This share was then applied to the total development figure to find an estimate for what proportion of development corresponded with arms exports. As of 2008, the UK MoD no longer tracks the financial value of UK arms exports, so following the same process is impossible. However, there is data on the financial value of the UK's arms exports up until the last two reporting periods. Using an average based on the 2005-08 average of arms exports as a proportion of UK arms sales (domestic plus exports) from the UKDS page, arms exports are approximately 40 percent of total arms purchases from UK arms producers. This proportion was assumed to be the same for the amount of development dedicated that contributes to arms exports.

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<sup>19</sup>Macronomics. 'European Government Bonds: Back to the Future?' 1 December 2010. <<http://macronomy.blogspot.com/2010/12/european-government-bonds-back-to.html>>.

## Issues

1. The DSO covers both arms producers and security companies. The latter might not fall into the traditional view of arms production. There is no widely accepted definition of what is covered under 'security industry' and it is possible that some or even many of these companies provide civil security products and services.<sup>20</sup>
  - a. Suggested solution: develop a deeper understanding of the different ways 'security' is being used that could have an impact on the amount of money the UK government spends on supporting the security industry in relation to the arms industry and 'defence.' See if these definitions can be operationalised to provide a range of subsidies that fall outside of arms exports.
2. Another aspect of concern is the growing number of dual-use items. How are they accounted for in arms exports and subsidies? If they end up covered by the civilian support activities, then subsidies for arms exports are being underestimated.
3. If military spending cuts are implemented and remain in place for the longer term, it will be necessary to reassess the subsidy estimates, e.g., to account for lower salaries for military attachés. In January 2011, Defence Secretary Liam Fox issued a call to replace high-ranking military attachés with lower ranking officers in an effort to rein in the costs of housing and paying senior military officers.<sup>21</sup>
4. There needs to be more discussion on the more qualitative aspects of these subsidies. For instance, if high-ranking military officers are removed from being military attachés in a cost-cutting measure, the role, influence, importance, etc. of military attachés is not necessarily diminished. What kinds of roles are these attachés playing that are qualitatively different than what other advisers play?
5. It would be helpful to know how much is spent on UKTI Export Support Team, what is meant by chargeable and how much is made back, if that is the case.
6. It would be necessary to investigate further whether all of UKTI's arms export support is confined to the DSO or if other parts of the ministry provide additional support. It is likely there is broader cooperation.
7. Since ECGD has changed its reporting, e.g., no longer providing figures for total at-risk amounts (as opposed to annual amounts) that are attributed to arms exports, and because the amount of support to arms exports has dropped significantly over that last two reporting periods, it is possible that the amount of arms business that is a share of total liability has declined from the £5,000 million figure provided in earlier work on arms export subsidies (e.g., see Ingram and Isbister 2004).
8. Because reporting data for the ECGD has changed (in particular, for arms export supports as a share of total liability and the FREF breakdown), there

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<sup>20</sup> Jackson, Susan. 'Arms Production.' *SIPRI Yearbook 2010*. pp. 251-283.

<sup>21</sup> Leake, Christopher. 'Fox Takes His Spending Axe to Forces 'Ferrer Rocher Club': High-ranking Military Attaches to Be Cut Back.' *Mailonline*. 19 January 2011. <<http://www.dailymail.co.uk/news/article-1347616/Fox-takes-spending-axe-Forces-Ferrero-Rocher-Club-High-ranking-military-attaches-cut-back.html>>.

will be discrepancies between the calculation here and those made elsewhere in earlier reports.

- a. Suggested solution: It would be useful to figure out whether it is possible to develop a proxy to stand in for the share and the FREF figures, possibly by calculating the magnitude of change in other aspects of the ECGD that might translate into understanding the share and the FREF. It likely would need to take into account how the deals are structured, e.g., how long and what are the terms.
9. This assessment does not include an estimate on presumed arms export-related savings on overhead. There needs to be more discussion on the underlying assumptions. For instance, perhaps arms exports do reduce overhead, but for the buyer or the seller? It is possible that these savings are being claimed by the customer (the UK government) but instead are really a benefit to the seller (the UK arms producer). There also is an issue of how costs are recouped in practice. For example, what terms are written into arms contracts to account for exports made after the full first-run price has been paid by the initial buyer (i.e., the UK government)?
10. This assessment relies on an earlier estimate on the direct distortion of MoD procurement choices. This estimate needs a more in-depth examination of the years covered in this study as well as a clearer methodology on what is included in the estimate and why.
11. There are serious issues with the development figure. The first one is assuming that the proportion of development that goes to arms exports is the same as the proportion of arms sales that go to export. The other is the lack of more current data since the MoD stopped compiling these figures.
12. Regarding issues on other potential sources of subsidies, further investigation into procurement practices would illuminate what factors go into procurement decisions and their impact on final costs (both as estimates and in reality). For example, the inclusion of training by RAF pilots in Typhoon export deals is not necessarily accounted for which means the training could be considered an export subsidy.