

# PARALLEL MARKETS: CORRUPTION IN THE INTERNATIONAL ARMS TRADE

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*Parallel markets: corruption in the international arms trade* is the text of the 2005 CAAT Lecture that took place on the 9th February at the London School of Economics.

The lecture was given by Joe Roeber, a political economist who has been a lecturer at London University as well as a journalist for the *Times* and the *Economist*. His current membership of Transparency International, the non-governmental organisation devoted to combating corruption, puts him in an excellent position to speak on the highly topical issue of corruption and the international arms trade.

The opinions expressed are those of the lecturer. These do not necessarily reflect those of CAAT as an organisation.

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# Introduction

Some years ago, a German Minister of foreign trade said “A time of war is also a time of gold-diggers.” This was at the time of the tanks bribery affair that brought down the Kohl government. In the arms business, it’s always a time of war.

The text for today reads:

- The arms trade is the most corrupt of all legal international trades. Establishing this is going to be the main part of the talk.
- Corruption distorts and inflates arms procurement.
- Removing or even significantly reducing corruption would do more to reform the trade than any other single act.

We can’t put a figure on it, but we can draw some lines around it. The value of the arms trade was \$28 billion in 2003. It was a low year: the trade had averaged \$10 billion a year more than that in the 5 years 1999–2003. Lets have a quick look at the structure of that trade.

1. Exports are highly concentrated: the US accounts for 49 % of the trade; and the top four exporters (USA, UK, France and Russia) account for over three-quarters (see Table 1). A crude distinction might be between the non-bribing US and the rest, but it is only crude. Although US exporters are unable to bribe quite so outrageously as the rest because of the Foreign Corrupt Practices Act of 1972, I am assured that some of them manage to finds ways of making payments.
2. Importers are grouped into proliferating regions of instability: Middle East, Indian subcontinent and Far East (see Table 2). The large share accounted for by Saudi Arabia falls under that heading but, as we shall see, it may have other explanations. It has not served to equip them to defend themselves at times of crisis.

One of the paradoxes of the arms trade, given the grip it has on politics and the public imagination, is how small it is, less than half a per cent of total world trade, but it is large in other ways: the arms trade may account for as much as one-half of total corruption. These figures are open to attack and I

**Table 1. Arms deliveries to the world, 1996–2003**

Rank	Supplier	Deliveries value (in current US\$million)	% of total deliveries
1	United States	151,867	49
2	United Kingdom	43,000	14
3	France	30,200	10
4	Russia	26,200	8
5	Germany	10,800	3
6	China	5,600	2
7	Ukraine	5,200	2
8	Sweden	4,900	2
9	Israel	4,100	1
10	Italy	2,700	1

(Sourced from Congressional Research Service, 'Conventional Arms Transfers to Developing Nations, 1996–2003', 26 August, 2004)

shall explain. Let us just say at this stage of the argument that the industry's share of corruption is grossly disproportionate to its share of trade.

Told this, people are likely to shrug their shoulders. To many – probably most – expert observers, it is peripheral, an add-on. So little significance does it have for them, the subject has not been studied at all. In all the huge literature in the nexus of defence, foreign policy and the arms business, there are no references to studies of corruption and its effects and only one book, Mark Phythian's history of UK arms trade policy, where it is taken seriously. Indeed, talking to experts, I was given the distinct impression that talk about corruption is faintly distasteful, even declass , servants' tattle. Serious students of the industry, both friendly and unfriendly, concern themselves with strategy and mat riel. They share the comfortable assumption that bribery does not affect main procurement decisions, taken by professionals in response to strategic need

**Table 2. Arms deliveries to developing nations, 1996–2003**

Rank	Recipient	Deliveries value (in current US\$million)
1	Saudi Arabia	61,100
2	Taiwan	19,400
3	China	10,200
4	Egypt	9,800
5	South Korea	8,300
6	Israel	7,700
7	U.A.E.	7,700
8	Kuwait	6,500
9	India	6,000
10	Pakistan	4,300

(Sourced from Congressional Research Service, 'Conventional Arms Transfers to Developing Nations, 1996–2003', 26 August, 2004)

and within budgets determined by Cabinet decision etc etc. This is wrong, entirely wrong. Corruption is not peripheral; it acts at the centre of procurement decision-making.

What else would you expect? Economists tell us that a rational man who stands to benefit from the decisions he makes will tend to take decisions that increase his benefit. This is more than just intuitive common-sense; it is axiomatic. The consequences are dire: when every deal with the Third World carries a commission (bribe) to the buyer, the result is waste and, however rational to the self-interested decision-maker, a sort of irrationality in arms procurement.

A clear statement of the consequences of corruption came 40 years ago from Donald Stokes, lorry salesman and car magnate. Given the job of developing an export strategy for the British arms industry, he reported to the government

that “a great many arms sales were made not because anyone wanted the arms, but because of the commission involved en route” (Quoted in Phythian). This is the core of the case against bribery, that it is not just a simple add-on to the procurement process but distorts the decisions. What would the equilibrium level of trade be without the stimulus of corruption? Once it ceased to be a honey-pot for the enrichment of the well-connected, it would dwindle into an irreducible strategic reality. If I have an objective, that is it: to reduce the arms trade to a level that is no larger than it needs to be.

I’ll make a couple of points before I get more deeply into the argument.

- “Corrupt” is a capacious word. Many of you may take the view that the arms trade is ipso facto corrupt, meaning morally depraved. That use of the word is etymologically correct but it is not analytically helpful – apart from being, in my view, wrong. For reasons that will become obvious, I am using the word in a narrower sense: the exchange of favours for some direct benefit.
- “Commissions” is the preferred euphemism for “bribes”. Companies pay commissions (innocently) to middlemen who pay bribes (wickedly) to the men of influence. It is a handy formulation because it allows companies to bribe while claiming ignorance of what the middleman was doing.
- I have limited the discussion to the legal trade because illegal trades (of many sorts: drugs and sex, arms smuggling and black markets) already fall under existing laws, however lax. Under the protection of governments from either or both sides of the deal, the official reality is grey and in some ways more sinister than a colourful Bond stereotype.



# The case of South Africa

The main case for tonight is the South African arms deal of 1999. It was born amid a storm of controversy. There was no question that arms were needed; the questions were what sort, for what purposes and how much they should cost. A review of the country's defence needs had come up in 1997 with four uncosted options appropriate to a country with no well-armed neighbours. The package that emerged in 1999 after, I was assured by the late Rocky Williams who had been centrally involved, heavy selling by the arms companies, was a hi-tech defence package costing R29 billion (then US \$4.8 billion) for state-of-art aircraft, deep water ships and submarines. This is now, with the cost of financing and the weakening of the rand, turning into a R66 billion (now US \$9.1 billion) deal and it is already not enough.

Post-apartheid South Africa is not facing enemies needing this sort of hardware. Moreover, the money is desperately needed for social programmes like health, roads, education and housing. The government – that is, the ruling Africa National Congress party (ANC) with control of Parliament – brushed the objections aside with grandiloquent talk of the country's place on the world stage as the policeman of Southern Africa and guarantor of regional stability. As for the budget, by a sort of magic, the arms deal would pull in a multiple of its cost in the form of "offsets", investments by the suppliers that would generate foreign exchange earnings and employment. According to this fairy tale (for offsets are as easily forgotten as promised) the programme was going to draw in investments of Rand 111 billion, more than three times the cost of the deal, and create 65,000 jobs.

Even before the deal was officially announced, an MP, the feisty and courageous Patricia de Lille, announced in Parliament she'd been given a dossier by a group of concerned ANC members claiming that the deal had been corrupt. It named prominent ANC members who were said to have received bribes from arms companies. This led to an attempt in Parliament to have the deal looked into, a threat efficiently seen off by the government; first, by crushing SCOPA, the parliamentary oversight committee; second, by manoeuvring the only independent investigator (the Heath Special Investigation Unit) off the case before consigning it to a government-controlled "joint investigation committee". The expected pail of whitewash came out 2 years later.

There had already been enough peculiarities in the arms deal to raise suspicion. Why were deep water ships needed for coastal defence? Why would a country facing a few elderly fighters need state-of-art BAE/Saab Gripens? (It had recently taken delivery of 2 squadrons of Impalas and didn't have enough pilots to fly them.) The choice of BAE's Hawk trainer against the recommendations of the airforce was even more blatant. The plane failed its technical evaluation until the parameters were adjusted to favour it. It only passed the final test when the Cabinet committee determined that price was not to be taken into consideration – just as well when the Hawk cost twice as much as the plane the airforce wanted, the Aermacchi. Then there were the Corvettes for which only Britain and Spain were in competition until then-deputy president Mbeki went to Germany. It was later alleged that Defence Minister Joe Modise received an interest-free loan from Germany by a rather convoluted route.

Questionable favouritism in the awarding of contracts to so-called “black empowerment” companies in the offset programme was even more rife, involving friends and relatives of ministers and the President's brother, Moelitsu Mbeki. The head of procurement in the Defence Ministry, Chippy Shaikh, was the brother of a director of one of the main contractors and head of an associated black empowerment company. Foreign bidders were given to understand that their chances of success would be enhanced by choosing the right partners. Bell Helicopters of the USA withdrew from the bidding when it was told that taking on a favoured black empowerment partner might help success. In the event, the successful bidder, Agusta, made the required deal. This was more than just domestic corruption. It emerged directly from the programme of offsets.

These issues have re-emerged in two cases that are currently in the Courts. Until a judgement is made – at the time of writing (February 05) still not due for some months – they must be regarded as unproven allegations, though freely reported in newspapers and discussed without challenge so far. Last year the trial started in Durban of Chippy's brother, Schabir Shaikh, a businessman and director of a subsidiary of the French defense company Thales. That was October; it is still going on. African Defense Systems (ADS), had been given the contract for fitting up the three corvettes with a combat suite, a communication and fire control system. The charges brought by the Public Prosecutor include corruption and fraud. The corruption charges concern Shaikh's relationship with the now-Deputy President, Jacob Zuma and payments made to Shaikh's companies in 2000 by Thales (or Thomson or Thint), allegedly for protection from Parliamentary action. At the time of writing, we do not know what explanations the defence will offer but we do know that, paid or not, Parliamentary scrutiny was indeed stopped by the ANC leadership.

The other case, a civil claim for Rand 150 million, has been brought by the disappointed under-bidder for a subcontract for the 1.3 billion Rand (now 3 billion Rand) combat suite. Richard Young, CEO of an electronics company, C2I2, had worked closely with the South African navy on designing the system and then lost out in competition. He alleges that the company had been manoeuvred out of the competition by questionable use of the rules, loading up the quote with a “risk” premium. He has been pressing for – and, after a long legal battle, was rewarded in early January by – the disclosure of early drafts of the whitewash report. The draft, or more tellingly the excisions, appears to confirm this questionable use of rules to exclude certain bidders, particularly concerning the awarding of contracts for unwanted aircraft to BAE and its partner Saab.

The South African story contains most of the key elements that will concern us.

- The sums involved are large and within the effective control of a small group of people, the leaders of the ANC.
- The government’s decisions were difficult to analyse because of their complexity, strategically and technically. Prices were impossible to second-guess. Criticism was easily fobbed off.
- Although South Africa’s strategic needs had been carefully analysed in a Defence Review, the resulting package bore little relation to it.
- Much was made of the benefits for the South African economy of the offsets programme. (Offsets are a very ambivalent sort of benefit and impossible to police.)
- The bribes on offer are life-changing in relation to the circumstances of the targets.

# Hard-wired for corruption

How do we make sense of this, a string of anecdotes? It would be handy to have national statistics of bribery but, unsurprisingly, there are none. The closest one can get to comprehensive, systematically-collected data on corruption in the trade would be found in restricted reports by the intelligence agencies – or the National Audit Office report suppressed by successive UK governments. The word does get out. In 1997, I was told in Washington that a mid-nineties report by the CIA concluded arms trade corruption then accounted for 40-45% of the total corruption in world trade. You may well wonder how such a figure could be arrived at but, as we shall see, there are ways through the problem that can lead us to a rational conclusion.

The nearest to a public statistical compilation I have found comes from the US Department of Commerce. Its Compliance Department collects reports of corrupt competition to monitor performance under the OECD Convention. According to its annual report on compliance, rather more than half of the bribe offers reported to them are for defence contracts. This is to be compared with a share of world trade of less than one-half of one per cent.

Much of world trade does not lend itself to corruption. A more relevant comparison would be with a group of trades that do. The US State Department gave me a list of five “most corrupt” international trades. These are, apart from arms, infrastructure or civil engineering projects, telecommunications, energy and civil aviation. (Ipso facto illegal trades like sex and drugs do not qualify.) When I last looked at it, that group accounted for about 10 per cent of world trade – of which arms, defence equipment and services account for about 5 per cent. Simple maths tells us that arms is indeed the most corrupt of all legal trades.

More impressionistically, we could listen to people close to the trade, a sort of vox pop.

- One of the few prepared to be quoted is Jonathan M. Winer, former Deputy Assistant Secretary of State. He wrote to me: “The notion that the Europeans offer and the Africans take bribes isn’t at all the case in regards to arms. Everybody takes bribes from everybody, and if not bribes, gratuities, benefits, undue advantage, commissions, contracts for friends and relationships, other benefits material or political, and so on.”

- Col Terence Taylor, strategic analyst and head of the IISS office in Washington DC, told me “A common feature of arms sales to the third world is the payment of a commission to the buyer.” This is cautiously put. More generally, but not for quotation, I have been told it is a reasonable starting assumption that every defence transaction with the developing world (more than half of world trade) is accompanied by commission payments for the buyers – the politicians, the military, civil servants and their well-placed friends.
- A senior manager on the marketing side of a huge defence conglomerate, now retired, said that, in 20 years of selling defence systems, only twice did he not pay a commission to the buyer. When life-changing sums are on offer, this must indeed be rare.
- A specialist in financial investigation with a worldwide business estimated on the strength of wide experience that 90 per cent of arms transactions are corrupt. (I think he was being careful.)

Government officials can be refreshingly open about the whole business.

- The French aircraft company, Dassault, made a “campaign contribution” to the Socialist Party of Belgium having secured a contract for upgrading F-16s, a job for which the company was not obviously qualified. (Actually, less to “secure” the contract than a modest and routine expression of gratitude.) At his judicial examination in 1995, Serge Dassault said that “everyone pays commissions”. His government agreed. When the Belgian courts issued a warrant for Dassault’s arrest, the French Minister of Foreign Trade protested that commissions are a normal part (“aides naturelles”) of the arms business and had been organised in that manner for decades.
- In June last year, a former Russian defence minister said arms deals in many parts of the world were possible “only when handing over some kind of commission to the buyer”.

Before getting so far, we might already have suspected the arms trade would come at the top of the list by reason of its organisation. The “most corrupt” trades I mentioned all share structural features, some of which have been listed apropos South Africa. The projects are large and discrete. They appear at random intervals. Each can, separately, make the difference between a comfortable life and near-death for the chronically hungry suppliers. Competition for business is fierce and management is aware that stock markets do not reward high-principled losers. In the developing world, the decision to purchase rests in the hands of an unaccountable political elite. The local culture

may favour the payment of bribes as a rational exchange of favours. In such circumstances, companies feel they have no alternative to paying bribes if they want to stay in the business.

The arms business has all of this PLUS two features that set it apart from the others.

- It is an opaque market. There is nothing particularly sinister in that; all companies would work behind screens if they could; but in any halfway efficient market they cannot get away with it. The arms trade gets away with it because defence goods are complex and each contract contains a mix of special requirements. Comparison is remarkably difficult and effective monitoring by public watchdogs is all but impossible. An unknowable price can be manipulated to accommodate any amount of covert payments.
- The second of its unique features is more devastating: the secrecy that cloaks all of its activities. This privilege is allowed the industry because of its role in national security. I'll come back to that. The, as one might say, operational point is that secrecy will always be abused. If nothing else, the Scott Report told us that. (For non-Brits, Mr Justice Sir Richard Scott was given the job of unpicking problems raised by selling dual-use equipment to Iraq, during the Iran-Iraq War, when there was an embargo.) Whatever the reasons for granting the privilege of secrecy, it offers a standing temptation to conceal incompetence and deflect political embarrassment, as Scott eloquently demonstrated, and steal. The obvious example is the slush funds used for such payments. Peter Clark, the head of FCPA prosecutions in the US Department of Justice, said to me, "Unaccountable money generates greed." (The Foreign Corrupt Practices Act was passed in 1977 following the Watergate-inspired investigation of the use of corporate slush-funds. It criminalises the payment of bribes to foreign officials.) People presiding over money they do not have to account for – usually because it is illegal – are tempted to take some for themselves. This was alleged in a BBC television programme to have happened in the BAE "slush fund" case, which is presently under police investigation. It's a cliché in CIA thrillers. The reality is that very little of what happens in the arms business is truly secret and even less needs to be.

If an organisation consultant from Mars were given the job of designing an industry with the express purpose of making it corrupt, he might have come up with something looking very like the arms industry. It is hard-wired for corruption.

# BAE, Thales, Thyssen and Boeing

Let us look briefly at recent stories that fit this scheme, starting with some home-grown problems. Four months ago, the British police arrested an ex-civil servant, “on suspicion of committing offences under the prevention of corruption acts”. He was said to have taken hospitality. Chickenfeed, you might say and you’d be right. Mr Porter’s “gifts” were the merest tip of the iceberg of BAE’s generosity. The arrest was a fruit of a 5-month investigation into allegations that BAE has been running a £60 million “slush fund” for entertaining Saudi notables. BAE was said to be particularly attentive to the comfort of the key Saudi politician in charge of British arms purchases, Prince Turki bin Nasser. As well it might be: BAE is the primary contractor for the £40 billion Al Yamamah arms deal with Saudi Arabia, the biggest arms deal in British history; and any slush fund would be the merest tip of a vastly bigger iceberg: the never-documented but widely-assumed payment of billions of pounds in commissions, mostly, it would be reasonable to assume, to favoured members of the ruling family and their men of business.

The one chance to find out how much was paid, a 1992 report by the National Audit Office, was suppressed by the Parliamentary Accounts Committee – the committee for which it had been prepared – on public interest grounds. Labour came to power with a promise to publish the report and then changed its mind. Having worked for the Saudis, I can guess why. Although apologists would say that such payments are “part of the culture”, exposure is not to be forgiven. According to close watchers of the negotiation in the mid-1980s (which included the CIA), the commissions ran at 30-35 per cent, hence the billions mentioned above. Reality is likely to have been more complex because different rates would have been paid on different sorts of equipment and services. But we do know that Thorn Electrical paid 25 per cent on a contract for electrical fuses worth £40 million. We also know Rolls Royce paid 15 per cent on a contract for jet engines worth several hundred millions, rising to 100 per cent on money above a target price. Those details became public when the company was sued for £100 million in 1997, by a company connected with brothers-in-law to King Fahd.

The main Al Yamamah payments were not illegal at the time of making them but, if the allegations are correct, the slush fund would appear to have been active after the laws had changed and this is being investigated. These payments are not something the Saudis wanted publicised. It is presumably out of deference to such sensitivities that successive UK governments – Mrs

Thatcher's, John Major's, Tony Blair's – fought in the House of Commons against the many attempts by MPs to drag the issue into the open and suppressed the NAO report. The implications of their message were clear – and mendacious: no commissions were paid. It is possible that family feeling was mixed in with the deference. Mrs Thatcher's son, Mark, was often mentioned in this connection.

Later, what may have been an attempt to cut a slice of the Al Yamamah pie was revealed when a member of the government, the Defence Minister, Jonathan Aitken, was discovered enjoying the hospitality of King Fahd's son, Prince Mohammed, at the Ritz in Paris. Aitken, who also had responsibility for defence exports, was accompanying a business colleague to talk about commissions to be paid on arms deals the Saudis were about to sign with British companies. The hysteria and wild gyrations that followed might lead reasonable people to conclude that Aitken was hiding something more interesting than an undeclared wine bill. The Guardian had been a little tactless. Aitken took the case to Court, brandishing "the sword of truth", determined to cut out the twisted canker of British journalism. He sued for libel and was jailed for perjury. One would need a heart of stone not to laugh.

The other main player in the South African case, the French defence contractor, Thales – the company accused of paying bribes to the Deputy-President – has been and is still, so far as I know, engaged in arbitration with the Taiwanese government over the \$500 million paid as commissions on the purchase in 1991 of 6 Lafayette frigates, worth FF 14.6 bn (\$2.5 bn). The money flowed everywhere, to Beijing, Taipei, Paris and Geneva. Among them was said to have been the former Foreign Minister, Roland Dumas, whose mistress had been hired by the oil company Elf, to open the back door to his office. According to Elf's Corsican master of corruption, Alfred Sirven, she had been lent to Thomson-CSF (as Thales was then called) to "persuade" the government to lift a ban on the sale of arms to Taiwan, laid down by de Gaulle. In an interview with *Le Figaro* Dumas himself said that more than \$500 million went out in bribes to a list of beneficiaries known to him and approved by Mitterand himself. The policy was changed. The examining magistrates were able to determine that the girlfriend was paid 65 million francs (about \$11 million). She later said it was 160 million Francs but denied that she paid Dumas any of the money qua money; she merely spent lots of it on him. Raised eyebrows: it is unusual in this world that the middleman gets the rewards when the big man does all the heavy lifting. Dumas was found guilty of misappropriation of public funds in 2001, appealed and, two years later, was pardoned on the grounds that he could not have known the money his girlfriend lavished on him was corruptly obtained.



From Elf the trail wound across the frontier via a deal associated with the company's purchase of the ruinously decrepit Leuna oil refinery in East Germany where the ramifications completed the destruction of the German ex-Chancellor, Helmut Kohl. That process had been started at the end of 1999 by the revelation of bribes to secure the sale of tanks to Saudi Arabia nearly 10 years before. Following the Iraq invasion of Kuwait in August 1990, the Saudis developed an urgent need for more tanks and agreed in September that year to buy 36 from Thyssen in Bavaria. A price of DM 446 Mn (\$232 mn), twice Thyssen's going price for the tanks, was "negotiated" by the middleman in the deal, a Bavarian fixer called Karl-Heinz Schreiber. It would have been a smooth, pain-free boondoggle except that half the tanks were deemed by the Foreign Ministry to have a warlike purpose and were denied export licences. The well-connected Schreiber contacted the Ministry of Defence, the Foreign Ministry was overruled and the contract was approved. Money was paid to Schreiber by Thyssen and by him to the CDU Treasurer – in a Swiss car park, a nice touch. None of it was declared as part of CDU funds. In the last couple of months, both Schreiber and his contact, Holger Pfahls, a leading party functionary, have been extradited from their overseas bolt-holes to face tax charges.

Strictly speaking, my last story does not belong here. The case of the Boeing air tankers came into the open in November 2003 with the dismissal of two senior Boeing managers followed a week later by the resignation of the Chief Executive. The Chief Financial Officer had negotiated a \$250,000/year job with Darleen Druyun while she was the US Air Force's second-ranking acquisition officer and responsible for many Boeing contracts. The biggest of these deals (now shelved) was a controversial and much-debated contract worth up to \$23 billion to lease air refuelling tankers. In October last year (2004) Druyun was sentenced to nine months in jail for conspiracy; Sears, the CFO, has yet to be sentenced. [Stop Press: he was given four months.] The story lacks an international trade dimension but, in most other ways, it is exemplary: questionable reasoning in the murky zone of national security, huge sums of money swung by discretionary decisions and covert exchanges of benefits in the hidden market. The Iron Triangle did its stuff. (For those who don't know the phrase, it is the industry/military/political interests united around common objectives, mainly increasing defence spending.) Politicians and the Pentagon were heavily involved. It is already clear that it had as much, if not more, to do with keeping the assembly line for Boeing's civilian 767 airliner running as it had with military need. Ms Druyun's interests were more personal.

She had promised to cooperate and didn't. Eventually, when she failed lie detector tests, she came clean and gave details of decisions favouring Boeing with well-padded contracts out of "gratitude" to the company for hiring her

daughter and son-in-law, and then herself. She inflated prices for the air tankers as a way to “ingratiate herself” with the company and provide “a parting gift to Boeing” before resigning from the Air Force. (More raised eyebrows: Boeing says it is surprised by the revelations, though it would be unusual, not to say self-defeating, to make gestures of gratitude in secret.) Ms Druyun did more than \$4 billion of favours for Boeing and got a \$250,000/yr job. A good deal all round, except for the American tax-payer.

# Obstacles to change

If the problem is as bad as I suggest, why is it allowed to persist? First, in all countries with military pretensions, an indigenous arms industry has a special position – for reasons of national security, usefulness as a tool of foreign policy and its contributions to the economy. The result is that governments support exports with some enthusiasm and not a little money – subsidies of between £450 and 950 million in the UK and \$7.6 billion in the US. Supporting exports as they do, governments are inevitably complicit in the corruption needed to sell them. They are not good candidates for membership in any reform movement.

Companies tell us they wouldn't pay bribes if they didn't have to. I'd believe that more if they'd shown more interest in the initiatives I've been involved in. There have been no responses to my requests for interview, nor replies to invitations to the three conferences Transparency International (TI) helped to organise. (To be fair, I was offered help by a senior figure in the arms nomenclatura. He responded to one of my despairing letters, a cold mail-shot, gave me lunches at the House of Lords and tea at his club – and none of the help he had offered. I was not surprised. It would have been extraordinary if someone from his background had cooperated. An old hand in military intelligence, it was far more likely that he was finding out what I was up to for his mates in Whitehall. Once he had satisfied himself I was harmless, he cut me off. Very charmingly: "I don't see any point in our meeting again.") Maybe they are not as reluctant participants as they claim. Corruption is a handy marketing tool, allowing companies to engage in non-price non-performance competition and levelling the playing-field with the dominant US suppliers. Corruption increases the size of the market and eliminating or merely reducing it will shrink it. If I know this, the companies know it. And we can be sure they don't want it.

What is the cost of corruption in the arms trade? Impossible to say. Even if I were to estimate, using a crude and fairly widespread 10 per cent rule of thumb, I could not say much more than that bribes in the international arms trade amount to \$3 billion a year, a large sum but not huge – and pretty unconvincing at that. To that should be added the cost of the arms that would not have been bought without the bribes to kick the orders along. What would that be, 10 per cent? 50 per cent? That would take the cost up to a range of \$6 – 18 billion. But even that does not get to the heart of a cost that should be seen in relation to the country's poverty. The \$5 billion (now nearer \$9 billion)

of the South African arms deal is not just too much in relation to the country's defence needs, it is a colossal diversion of resources from desperately-needed social investment.

I should have started this section off by saying there are a real and practical difficulties in attacking the problem, even if companies and governments wanted to. They cannot act alone without ceding market share to their competitors. And they have difficulty in cooperating with competitors they do not trust. In the end, this could be the biggest obstacle to reform: the sheer wickedness of the players.

# Does it matter?

Why single out the arms trade? The industry is not big and the amounts involved are not huge. Arms are not the only trade open to corruption; there are those other “most corrupt” trades. Laws intended to catch them will catch arms as well. The newish OECD Convention should catch them all. (The OECD Convention against the bribery of foreign officials criminalises the practice much as the US FCPA, on which it was modelled.) The short answer to the question is that the arms trade is different. To repeat:

- It is uniquely susceptible to corruption.
- It sells goods into price-insensitive markets justified on national-security grounds. (I am repeating myself, but it is important: you may not have the money to buy ports or airliners, but you might well feel justified in buying weapons. If you are being bribed to do so, the excuse of national security is a good one and virtually immune to open debate. This affects the poorest countries.)
- By inflating the supply of arms, it opens another door to global instability.
- Laws like those arising from the OECD Convention are as yet untested. Some of the most affected governments have so far shown little enthusiasm for them. It is too early to tell.
- Governments have a long history of making special rules for their arms companies on national interest grounds. This may continue, albeit covertly.

So my answer to the question is, yes, arms is a special case; the damage done by corruption is far greater than the dumb numbers seem to suggest; and it does deserve special treatment.

# What is to be done?

Let me summarise the argument so far.

- Defence companies bribe importing governments to buy arms they may not need with money they cannot afford.
- They are helped in this by an extraordinary level of support given by host governments, because...
- exports are regarded as vital to the health of the defence industrial base which is, in turn, an important adjunct of...
- national security, foreign policy and the domestic economy.
- Thus committed, the host governments are willy-nilly complicit in whatever actions are needed to get the exports.

This much is clear. What can be done about it is less so.

At the end of his life, sick, ruined, contemplating the failure to achieve his life's goal of saving the empire, Churchill said that being good and benevolent is of no use if nobody will listen to you or you haven't the power to make them do what you want. This is the problem facing all reformers.

I am going to take it that I have made a case for action. Like Churchill, we are looking for ways to persuade people or for the power to force them. This fits two broad approaches to the issue – indeed, to any issue: the indirect and the direct. The direct is the intuitively obvious approach. You define the problem, bring your guns to bear on it and blow it out of the water. What follows is a menu of direct actions and approaches mainly drawing from work being done by a team in TI(UK) that I'm involved with. (I am a member of the steering committee, but in no way a representative of this team.) The proposed actions fall into three groups.

- The first group (of 3 measures) is designed to enforce anti-corruption measures, using powers that could be made available to governments.
- The second group (2 suggestions) are voluntary, putting companies in the position of choosing the path of virtue.

- The third group (2 suggestions) is a sort of hybrid, though it does rest on powers to coerce good behaviour as in the first group. I call it a hybrid because in both cases – the OECD Convention and the EU Code of Conduct – there is potentially quite a lot of discretion in the use of information by governments to bring their own industries to heel. These are recent developments, only a few years old, and have yet to be tested in action.

It has not been part of my scheme to go far down this road, although we can explore these ideas in more detail if people are interested. The problems are obvious: how can you persuade someone, government or company, to do something they consider to be against their interests? To go no further than Britain, the absolute silence on the subject from major British arms manufacturers is eloquent. As for governments, the British government's foot-dragging over legislation for the OECD Convention speaks for itself. Not just the UK. When the idea of adding a Ninth Criterion to the EU Code of Conduct was being trailed in EU capitals four years ago, it was dropped under pressure from EU members – pressure that amounted to blackmail. (The Ninth criterion was intended to add an explicit commitment against corruption to the eight criteria governing arms exports: what it was permitted to sell and to whom. It was made clear that this would be used as an excuse to threaten the whole Code of Conduct and the government promoting the idea had to back down.) Importer governments are unenthusiastic to the point of catatonia, except for very few exceptional ones (eg Colombia). Where is the profit in virtue? This is a black thought for any reformer.

It may also be unfair. I have said there are good or, if not good, understandable reasons for the situation we are in and there are powerful and intermittently rational resistances to change. Governments support exports for reasons of national security, usefulness in foreign policy and national economic advantage. Companies are in a fiendishly intense field of competition in which bribery is not only essential, it is one of the most powerful marketing tools they have. Even if a quorum of European or OECD countries were to decide to bind their companies to take action, others would step into the breach. Russia, China and Israel are front rank competitors; not to mention Brazil, Romania, the Ukraine and the other second rank suppliers. It is fair to guess that none would hesitate to take advantage of the weakness, as they would see it, of their competitors. Cooperating with your fiendish competitors would require a degree of trust that doesn't exist.

Maybe we should start some way back up the decision chain. This is the indirect approach I mentioned. The justifications for special treatment I repeated above are all based on assumptions that can and should be

challenged – not with hostile intent, I do not mean that, but to test their strength and health. The world has changed with the end of the Cold War. It is changing with the increasing integration of the EU, in which the concept of the “post-modern state” casts a new light on the needs of defence. It is not unreasonable to expect policies to change with them. These raise questions that go beyond corruption so I shall leave them as questions, or issues, or topics to be addressed.

First, what is the place of a national defence industry in national security? Globalisation now allows us to spread the procurement net more widely. If the importance of a defence industrial base is accepted, should a new Europe not be thinking of European rather than national self-sufficiency?

Second, what is the role of arms exports in foreign policy? We already have export controls and codes that limit permissible sales – ignored and controversial as they are. Some question whether we should export at all. Tim Garden suggests a robust rule: that we should not export to any country with which we do not have a defence agreement. It is a question that must be answered.

Third, how important is the place of the arms industry in the economy? Does it really deserve such a special position as a creator of jobs and generator of foreign exchange? Sam Brittan’s CAAT paper of 4 years ago, and the NGO group analysis I mentioned both question the value to the economy of the industry and of exports in particular.

Questioning the need to support a defence industrial base on strategic grounds, questioning a special role for the industry in the economy, we must question the policy of supporting exports at any cost. The primary target of analysis would be the large subsidies the industry receives. British subsidies in the range £450-950 million are equivalent to between one-sixth and one-third of export revenues; US subsidies of \$7.6 bn/yr compare with \$20.9 bn/yr export sales, equivalent to one-third. This makes no economic sense. Why should the tax-payer buy exports for the companies?

The last item up for challenge is not so much a policy as a habit that is immune to rational analysis. I mean, of course, the passion for secrecy, a cloak under which anything can happen. I am assured by experts that very little in the arms trade is really secret; people can generally find what they need to know. And even less actually needs to be kept secret. If so, we should remove the cloak where it is not needed. At the least, the need for secrecy should be stringently examined and the exceptions to a general rule of openness sparingly conceded and clearly defined. This leaves, of course, the real reason



for much of the secrecy: the unwillingness of the men of influence in the importing countries to be exposed. Should our governments be offering them that protection?

I have now reached the end of this talk. My main purpose has been to demonstrate that the arms industry is unique both in its susceptibility to and in the level of corruption. I have given you five cases. I could have given you scores more to make the point. It receives quite exceptional support from governments to sell goods into a market where price is not the first concern. There is a lot of money slushing around in secrecy and a lot of well-placed and unscrupulous men who want – and, with some effort, can get – a piece of it. It is little wonder that the easy money on offer plays a major part in determining what happens. It is not peripheral to the business of selling arms; it is central. The problem is so peculiar and so damaging that it requires and deserves special treatment.

I shall finish with a personal note. I am not “against” the arms trade as such, and I am certainly not “for” it. I regard it as ugly but inescapable. People and nations want to defend themselves and will buy weapons to do so. Rather than wanting to abolish the trade, I want to improve it, make it open, transparent and efficient. What could be more innocent? ...or more subversive. By disabling corruption and by removing the special treatment the industry enjoys, we would go a long way to reducing the trade to what is strategically legitimate and ethically unobjectionable. That would take us closer to the objectives of CAAT than any other action I can think of.

Thank you.





CAAT was set up in 1974 and is a broad coalition of groups and individuals working for the reduction and ultimate abolition of the international arms trade, together with progressive demilitarisation within arms-producing countries

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