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Occasional Paper 8209
September, 1982

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*The author is very grateful to the Centre for the Study of Arms Control and International Security at the University of Lancaster, and its Director, Professor Ian Bellany, for the opportunity to carry out the research in this study and for generous support and advice during a year as Senior Visiting Research Fellow. Martin Edmonds and Michael Dillon of the Department of Politics of the University of Lancaster also provided invaluable advice. Research also was facilitated by the consultations of many in Britain, including Bruce George, Peter Nailor, Chris Smith, Paul Stares, and Trevor Taylor. The Center for International Studies, of the University of Missouri-St. Louis maintained long-distance support as well. Finally, thanks go to those in the British government, in defense industries, and at academic institutes and conference centers who were willing to be interviewed or make their research facilities available. The views and conclusions expressed here are those of the author alone.

The Question of Control in British Defense Sales Policy

Introduction

As Stanley and Pearton,[1] and others who have traced the politics of arms sales have noted, governments have sought to control sales for a variety of reasons and in a variety of ways. Among the reasons are desires to keep sophisticated arms and arms technologies from reaching enemies or regimes considered unstable or untrustworthy, to reward or strengthen favored, and punish or weaken disfavored foreign governments, to promote or restrict arms industries and national arms production capabilities, to increase the quantity and quality of arms available to the state's own armed forces, to prevent wars, balance power relations, or promote the war efforts of certain regimes in certain regions, to improve trade balances, and simply to keep track of the destination and use of arms sold abroad.

Control does not necessarily mean the limitation or reduction of sales abroad, but rather the potential for limitation or promotion of arms transfers, for information acquisition, and for linking arms transfers to foreign policy objectives. In the past, control has sometimes meant refusing sales or transfers to specific countries, establishment of aggregate limits on transfers for arms control or other purposes, or linking sales to foreign policy (rewards and punishments), economic policy (trade, industry, employment, finance), military policy (procurement, strategy, release of technology), or intelligence (keeping track of deals

and deliveries). Means of control include licenses, quantitative or qualitative restrictions and ceilings, end-use certification, public and legislative report requirements, arms control impact statements, legislative and executive review and veto powers, international agreements, and government ownership of the means of arms production.

The last point leads to the question, noted by Edmonds and Dillon[2] of "who controls the controllers?" Government ownership of the means of defense production could afford increased control over sales processes and consequences. Presumably it is easier to link arms trade to foreign policy goals if the government itself produces and markets the weapons; no unfettered weapons merchants would run around complicating national interests. Conceivably, though, rather than making arms transfers more closely serve government foreign policy goals, government ownership of or deep involvement in the defense business increases the state's <u>dependence</u> on sales and <u>reduces</u> policy choice. With such involvements, the government develops an interest, both financial and bureaucratic, in sales - and this interest could come to override other aspects of the national interest and effective control over sales.

In this study, the questions of who controls arms sales and for what purposes are examined using the British example. We will look both at controls adopted by and pressures brought to bear on the British government. Britain's traditional interests in the arms trade, as well as the evolving mixture of U.K. government stakes in the arms business mean that London will both be interested in controlling that trade and

in increasing it, and afford London the means to pursue both aims. While the government traditionally has maintained official distance from arms marketing, it has long reviewed important sales closely through licensing procedures, and more recently has been drawn more intimately into sales bargaining and promotion.

The British case provides a glimpse of the consequences for government policy of nationalized, semi-nationalized, and privately owned arms industries. In this mixed arms economy, there is a centuries old public weapons production sector, with the Royal Ordnance Factories (ROFs) producing infantry equipment for the British Army, augmented by nationalizations of the aircraft and shipbuilding industries during the 1970s. Even more recently, however, British Aerospace Corporation has been partially de-nationalized, or "privatised," with less successful efforts to do the same to both British Shipbuilders and the ROF's. Clearly, though, public holdings in defense production give Her Majesty's Government (HMG) -- regardless of political party dominance -- a built-in interest in overseas sales for jobs, return on investments, and longer production runs. Government also has significant interests in the private sector, however, again in terms of employment, returns on rather massive research and development subventions, and the availability of weapons for U.K. forces. The focus of ownership does not <u>determine</u> the interests, but can compound them.

As a medium power adjusting to a diminished world role, Britain nevertheless carries continued military responsibilities in NATO, for the remaining British dependencies -- as the Falklands episode vividly

recalls, and in Northern Ireland, as well as lingering political ambitions in a few regions (such as the Persian Gulf). The U.K. also maintains perhaps Europe's most diverse arms industry, with aspirations for an "independent" defense industrial base in land, sea, and air equipment -- though this is an increasingly problematic ambition. Nowhere were the conflicts among these ambitions and between ambition -- or responsibility -- and capability clearer than in the Prime Minister's statement, the very week in March 1982 when the Royal Navy was unprepared to expel a group of Argentinian merchants from South Georgia Island, to the effect that Britain must be ready and able to take on the Russians alone if necessary -- and hence must purchase the costly Trident system.

While Britain is unique in its amalgam of approaches to arms production, it also faces problems common to all arms exporting countries: the growing cost of weapons development -- leading to pressures for international or inter-company collaboration; the impact of overseas sales and sales competition on domestic jobs; competition from both established and newly emerging exporters such as Israel and Brazil; difficulties in penetrating foreign markets -- including the potentially lucrative American market; difficulties in predicting demand for certain types of systems and uncertainties about customers' political stability (the Iran shocks) and ability or willingness to pay; and potentially shrinking domestic and foreign markets for certain systems as world economic difficulties mount.

These problems affect the complex interaction of producers, controllers, and customers -- some of whom play more than one role simultaneously. The arms trade represents at the same time varied political and economic

costs and benefits. Britain clings to its nominally independent military role in world politics at least partly through military sales, seeking political ties to certain regimes (especially those with oil wealth) and a market sufficiently large to support the cost of developing modern weapons. While civilian production might provide more labor intensive jobs with less inflationary effects, military production undeniably keeps thousands working. Yet the weapons business is also costly, especially when large portions of public investment is committed to the notion that it is better to produce one's own weapons than to buy them conceivably more cheaply as needed abroad. Once in the sales business, government the nominal and ultimate controller, and the major defense customer for domestic industries, comes under intense pressure to become government the promoter.

Framework of British Defense Sales

Before considering the controls and pressures involved in British arms sales, a brief summary is in order of the agencies and procedures through which prospective arms deals must pass.[3] In terms of control potential, though, it should be remembered that all exports of new or used military equipment from the U.K. require licenses, and that all license applications are reviewed by relevant ministries.

In 1966, HMG established a Defence Sales Organization (DSO) within the Ministry of Defence (MOD) to facilitate sales in the wake of Britain's declining world role (loss of primary aircraft supplier role, for example) and the commercial thrust given U.S. Foreign Military Sales by Defense

Secretary Robert McNamara and his deputy Henry Kuss. While British companies would remain responsible for marketing their goods and for obtaining licenses through the Department of Trade,[4] the DSO would help cut through government red tape in obtaining clearances, coordinate inter-ministerial consideration of sales, promote U.K. defense products by organizing yearly exhibitions, engage the support of the armed services and defense attachés overseas, and provide advice and surveys of market prospects. The DSO also was given direct responsibility to market ROF products, and through extensive dealings with Iran, the MOD came to control a "quasi-non-governmental organization" (QUANGO) called International Military Services, Ltd. (IMS).

Inquiries about arms purchases generally come to MOD, from defense attachés in the field, or company representatives with foreign contacts, and are forwarded through the licensing process (see footnote 4) if details on a prospective contract have been worked out. A division of DSO, called DS13, arranges liaison with the other ministries which must review the application -- Foreign Office (FCO), and sometimes Export Credit (ECGD) and Treasury. Often the British government will be asked to issue a Memorandum of Understanding (MOU) and to stand behind a deal arranged by private companies. Since government-to-government sales have become increasingly popular, HMG has evolved informal ways of underwriting sales without technically becoming responsible for them. The use of IMS, to be discussed below, is one such means. Finally, if equipment has been jointly produced in collaboration with foreign firms or governments, inter-governmental

consultation about sales may be necessary. For sales to Warsaw Pact or other Communist countries, consultation and COCOM (Coordinating Committee on Export Controls) regulations devised by the Western bloc are employed.

Most of the 6000-7000 license applications received yearly by the U.K. are relatively routine, with fewer than 3% of applications formally refused, though controversial inquiries are discouraged before reaching the application stage. It has been estimated that up to 7% of applications were refused in earlier years, before export sales became such a primary concern for the British government and before review of applications became systematized. Applications which were formally refused in years past can now be discouraged early as criteria of acceptability are more apparent. If a prospective sale is large and/or politically controversial (in Britain or the customer's region), or involves restricted technologies, ministers themselves could be consulted; if they are unable to agree informally, inter-ministerial committees can be convened, and ultimately the Cabinet consulted.

Both the Foreign Office and MOD have established departments to facilitate communication in this deliberative process -- Defence Secretariat 13, and the Defence Department in FCO. Each Ministry wants to retain a separate capability to evaluate arms transfers, but in practice it appears that MOD plays the leading role in arms sales promotions. An undersecretary has maintained that the FCO is consulted on all proposals to sell arms, and opposes them only for "compelling" political or security reasons.[5] In practice, such opposition is rare, and the MOD seems well

aware of sensitive "no sale" areas where FCO might veto the release of certain types of military equipment. FCO would be unlikely to hear of arms purchase requests that were discouraged at an early stage by MOD, and hence the Foreign Office may not be fully aware of all interest by other countries in purchasing British arms. Ambassadors and embassy staff relay useful sales-related information to the FCO, which in turn can pass it to MOD, but while there is regular exchange of sales information, the Defence Ministry develops sales prospects generally without much consultation of the FCO.

Within MOD, two sets of perspectives seem evident: (1) U.K. armed services' concerns about acquisition of equipment and about release of sensitive technologies to the wrong people abroad -- with possible resultant use against the U.K.; and (2) sales concerns of DSO and those promoting exports of British equipment. Tailoring weapons design for export appeal ("exportability") traditionally has not been a primary concern of the armed forces; they demand weapons suited to British defense missions -- now largely concentrated in the North Atlantic and Northern European theaters, and readily available to British forces (not sold out from under). However, increasingly the DSO and political arguments that exports are necessary if the U.K. is to afford sophisticated weapons production have been making headway. Yet military leaders, still resisting commercialization somewhat, note that the most sophisticated weapons are not necessarily those with the greatest export appeal, for reasons of price and logistics.

Designed to increase defense sales volume, the DSO has affected the

government's control function. One of DSO's main tasks, at least as industry sees it, is to wave the flag inside the British government in favor of sales and saleable designs. The DSO has become a convenient lever for arms manufacturers to influence both license applications and arms procurement decisions, even decisions by other ministries. This does not mean that others invariably cave in to DSO pressure, or even that pressure is bluntly applied, but rather that a consistent voice for export authorization is now available with increasing representation on inter-ministerial and procurement committees.

Despite formal controls, British equipment still sometimes gets to the "wrong people," most frequently defined as communist states, terrorists, the Irish Republican Army (I.R.A.), etc. End-use, or "sole use"[6] provisions are part of many British deals, but enforcement is left to the Customs and Excise Department, with little or no follow-up by MOD or FCO. If a violator is identified, no new sales will be authorized, and private citizens can be prosecuted. In its license reviews, the Department of Trade seeks to detect bogus end-use documents, and FCO is aware of the problem, but there are many means to circumvent enforcement, and much interest in doing business. In fact, end-use requirements have become less specific in recent years; HMG now asks only that customers consult and inform London of retransfers of military equipment, rather than seeking HMG's formal permission. Current end-use provisions deal only with unauthorized retransfers rather than with <u>use</u>. The U.K. has also given up trying to distinguish offensive from defensive weapons, though some distinction as to repressive potential (e.g., machine guns) is still attempted in the

human rights area.

In a sense, most of Britain's decision-making on arms sales is reactive -- with cases considered individually as applications are made. Little in the way of general policy exists.[7] As noted below, departments have established certain rules about the release of sensitive technologies and about countries which are poor political or financial risks. Yet longer term policy re-evaluation and planning is sporadic. The Arms Control Research Unit in the Foreign Office undertook a classified study of medium term implications of arms sales, but evidently little use was made of the findings since they came during, and were lost in the transition between Labour and Conservative governments in 1979. The Conservatives changed Britain's approach to arms sales somewhat by easing back on human rights boycotts and restrictions, by providing higher level government backing in the form of sales teams and missions, and by calling publicly for more exportable designs and for manufacturers to reduce prices by scheduling payments over longer periods. Yet while disagreements between ministries can be referred to the Cabinet, the Cabinet Office, staffed by approximately 100 civil servants seconded from various ministries, has no permanent unit considering the political or economic implications and consequences of defense sales for British interests. _Ad hoc_ studies are occasionally authorized, however, as in an assessment of arms balances in the Middle East undertaken a few years ago.

Finally, there is no statutory requirement in Britain for consulting or even informing Parliament about prospective or existing sales. At least two parliamentary committees - Public Accounts and Defence --

investigate issues related to defense sales, but Whitehall is quite restrictive about the information it releases and the committees are handicapped by limited staff. Purportedly because of companies' and overseas customers' possible objections, HMG does not even release details or figures of sales to specific countries. The Government's annual White Paper on Defence Estimates provides aggregate figures, recently including breakdowns by types of weapons as well. However, various and important categories of goods are excluded.

The Pattern of British Defense Sales

Scarcity of data therefore means that estimates of U.K. sales volume are necessarily subject to doubt,[8] especially in view of the wide (sometimes differing by a factor of 2) variety of figures compiled in various sources, and presented in Table 1. In view of these discrepancies, it is best to look at trends in exports as judged from a number of data sources. The government and arms manufacturers can point to a steady increase in the current value of sales abroad, but corrected for inflation, or looking strictly at Third World sales, the increase is far less impressive even allowing for data variations. It seems to have been based largely on the petro-fueled Persian Gulf purchases of the mid-seventies. In recent years (1979-82), in fact, the real value of sales has hardly increased despite concerted sales efforts.[9] While the number of British overseas sales contracts generally has increased since the mid-1970s, Table 1b shows that the proportion of very large (over £1-million) sales has stayed relatively constant, averaging around 44%. According to the Stockholm International Peace Research Institute (SIPRI), Britain has

now dropped to fifth place in exports of major weapons, behind both France (at roughly three times Britain's volume) and Italy, and being pushed hard by Germany.[10]

In Table 2, sales are broken down by region, with necessarily varying criteria depending upon data sources. Generally, though important aircraft sales figures were unavailable by region for some years, the proportions are relatively constant. The Middle East accounted for most sales, but peaked in 1978 with Iranian orders; it fell back to its former figure of 30-40% of British exports thereafter. Asia and Africa picked up at least temporarily in 1980, but generally accounted for 5-12%. NATO quite consistently took around 20%, and Latin America fell in 1980 but generally accounted for between 15 and 30% of British sales. This indicates that Britain was not totally oriented toward the Middle East, though OPEC countries in general accounted for 36-38% of sales from 1966-77. The Middle East has ranked quite high in British aircraft exports as well, with an entire sales division of British Aerospace allocated to supplying the Saudi air force itself (construction as well as combat supplies). British aircraft have also gone recently to India and Latin America.

While the Third World (technically the financially better-off countries thereof) has been Britain's primary weapons market, the industrialized Western countries, and particularly the U.S., represent a substantial and growing market as well. The U.S. is now the third or fourth leading U.K. defense customer, as pressures have mounted for a more genuine "two-way street" in U.K.-U.S. defense purchases, and as British firms have become content with subcontracting for or co-producing

equipment with American firms. While the Sterling volume of sales is greatest in the Middle East, in terms of numbers of contracts the market is much more balanced. Table 2b shows that in 1979, Western Europe, Latin America, Asia, and Sub-Saharan Africa represented substantial markets; in 1981 more agreements were announced in the press with North America than with the Middle East, and Europe was a close third.

Furthermore, from the viewpoint of countries in those regions, Britain ranked higher as a source of supply in relation to other suppliers for North America, NATO, and Latin America than for the Mid East. Generally there has also been continuity in the British defense market over the past decade. Listings of purchasers, without distinction as to amount of purchase, in 1973-77, 1979, and 1981 showed that of 81 country customers (62 in the early 1980s), 22 bought goods in all three periods, and an additional 28 bought in two periods. This left 31 countries purchasing goods during only one portion of the decade.[11]

The breakdown of items exported (Table 3) shows that while aircraft accounted for the bulk of sales, ground equipment had a significant and more consistent share of around 20% of U.K. exports. Sea equipment was generally less than 10%, with electronics and communication evidently (when figures were available) providing another 20%. Ground equipment sales also seemed to grow more steadily from year to year: ship sales followed a boom or bust pattern. Growth in missile sales tapered off at decade's end, and data were insufficient to judge electronics growth rates, though if 1979 is an indication, they may not have been as spectacular as one would imagine for a glamour industry.

Finally, looking briefly at the question of costs and benefits of defense sales, we can quote government claims that defense sales account for roughly 80,000 jobs (140,000 direct and indirect "job opportunities" have recently been mentioned) and £1.5-billion of revenue in 1981, or 2½% of total U.K. exports, and 2½% of total U.K. defense production. The figure of 80,000 seems remarkably low for a defense industry estimated to contain between 9,000 and 10,000 contractors and sub-contractors. The average profit on defense exports is reported to have risen from 9 to 10%, on sales growth of 20-23% between 1976 and 1978.[12] Government (MOD) contracts with industries generally limit profit margins to between 11 and 14%, but this can vary. Procurement contracts can be based either on fixed price limits, to head off cost overruns, or cost-plus provisions allowing for inflation and unforeseen problems. Prices of exports are generally set higher than domestic sales, supposedly because of required warranties, promotional costs, etc. Different prices can be quoted to favored overseas customers as well, though customers tend to keep track. This affords companies the opportunity to make up for cash limits, as do certain export credit insurance arrangements discussed later.

One way of calculating sales benefits is to determine the return on government investment in defense production. The effect of nationalized industries is discussed below, but it has been noted that ROF exports have not often yielded a profit and often failed to return fixed overhead costs. The Government imposes levies on commercial exports of defense equipment designed at HMG's expense, in order to recoup such expenses. Because levies are variable and can be adjusted to help exporters meet

foreign price competition, levies have yielded only £9-million per year on government expenditures of hundreds of millions.[13]

The impetus to boost defense sales comes in part from the declining national budget base. Mary Kaldor has argued that Britain traditionally has exported more when able to afford less procurement for Her Majesty's forces, and vice-versa.[14] This substitution effect was evident in the Defence Secretary's commercial mission in 1981 to boost exports while cutting £200-million from the budget and still meeting NATO commitments to raise defense spending 3%. Defense production takes over 20% of U.K. R & D expenditure, and over 50% of government sponsored R & D,[15] and exports account for roughly 30% of that production (though for certain products this figure is higher). As seen in Table 3, defense export revenue almost exactly equals these yearly R & D expenditures. The close match seems due primarily to coincidental budgeting decisions (incremental inflation affected increases in R & D) and the basically stagnant real sales volume in recent years (rising mainly only with inflation). Little of the export revenue is directly returned to the government to offset HMG's costs in subsidies, advanced payments, loans, loan guarantees, and seed money for projects later cancelled.

In fact a number of myths have grown up around defense sales which do not appear to be valid. For instance, it is often claimed, especially by industry, that domestic procurement of defense goods is necessary for foreign sales, since prospective customers require a seal of approval by home forces. While customers might feel better with such assurances,

findings of inverse procurement-export correlations belie this claim. New forms of government warranties or memos of understanding can substitute for actual purchases, though manufacturers benefit when government buys more and holds goods in stock or in armed service inventories waiting for foreign customers.

It is also argued that defense sales provide longer production runs and therefore reduce unit costs. However, such marginal cost reductions vary greatly depending on weapon sophistication (speed, weight, technological add-ons); expensive systems can have relatively steep cost or production learning curves, with significant reductions coming with the first blocks of units, sometimes those bought by the producing government for its own forces.[16] Exports lengthen production runs, but may not reduce unit costs very much, and the exceedingly high cost of even mass produced sophisticated modern weapons discourage foreign purchasers unless government backed credit (or subsidies) are offered. The benefit is in keeping design and production teams working longer, in filling gaps between projects, and in providing the sales volume if domestic procurement falls short.

Furthermore, Trevor Taylor claims that R & D costs are not necessarily spread and reduced over longer production runs through exports. The most successful British arms exports, at least according to government figures, have generally been those requiring the least R & D.

> "Over the last five years military aircraft have provided only 16.8 percent of arms exports but have taken over 55 percent of official R & D funds .. Naval equipment accounted for over 20

> percent of the British total ... but took less than 16 percent of R & D funds. Most striking of all, ground equipment constituted over 55 percent of defence sales between 1975 and 1979 yet absorbed under 12 percent of R & D spending." 17

However, according to calculations reflected in Table 4, naval exports do not produce sufficient export revenue to cover their costs, expressed in central government expenditure on defense production. In this sense, on a purely cost accounting basis, the case for continuing such production in the face of scant sales seems questionable if exports are a major consideration. As seen in Table 4b as well, defense sales revenues have not consistently increased as a percentage of costs. This is true of land, sea, and air production, and taken as a percentage of production costs in each sector.

Criteria for Control

Andrew Pierre has described Britain as basically dominated by economic incentives in the arms sales business. He evidently agrees with the SIPRI classification of British arms sales as a commercial rather than strategic venture, and with Lawrence Freedman as citing "commercial pragmatism" as the main constraint on U.K. sales.[18] Yet the record of defense sales is somewhat more complicated than merely a commercial proposition. Freedman has pointed to a commitment to sell unless a compelling reason is found not to, and Edmonds with a slightly different nuance, to a "disposition to export arms, within a defined and established procedure of decision making in which 'careful and conscious selectivity' in allowing arms sales is exercised."[19] In

other words, Britain will sell arms but, according to the government, only after trying to think through the implications.

Economic implications and aspects of defense sales controls will be discussed later. First the question is to what extent political considerations still play a role, as clearly they did in the imperial hey-day, in U.K. arms transfers, and to what extent government officials really do think through implications. The fact that civil servants claim to be concerned lest a denial of a license application severely damage the government's relations with the customer nation can be taken two ways: either as a rationalization and apology for the fact that only 1-3% of applicants are refused, or as an indication that such deals do cement political relations.

Political Controls

One way in which economic interests relate to political interests is in the desire for an independent weapons manufacturing capability. Pierre takes the fact that Britain has been willing to depend on the U.S. for nuclear delivery vehicles and technology since 1961 as an indication that, unlike France, she no longer lays great stress on maintenance of "an independent foreign policy underpinned by an autonomous arms industry". In that sense Pierre reverses the conventional wisdom about French motivations a bit, arguing persuasively that there is more to Parisian arms policy than a mad grab for export revenue.[20]

However, albeit with a difference in ambition, much the same can be

said for Britain. Although the tradition in London is for less dirigisme or open government involvement in sales promotion, clearly British manufacturers and the Defence Sales Organization would like to match Paris' commercial success. But beyond money, civil servants, and MP's from both houses also still refer to independent forces and the need to be ready for possible wars.[21] They harken to the ill-preparation before World War II, despite the prospect that future wars would not resemble that conflict. Some refer to nuclear forces in this light -- even though Britain is far from independent in purchasing the likes of Trident. MP's of various parties call for autonomy in conventional weaponry as well. Again this may be an apologia for defense manufacturers' profits, or for trade unions' job concerns, but Britain still possesses basically autonomous conventional production capability (although key systems are imported), and it is a potent selling point when parliamentary votes are cast on defense budgets.

One indicator that commercial interests still do not quite rule the day in U.K. arms transfers is: the ongoing struggle of manufacturers and the DSO to overcome military service predominance in defense procurement. Weapons for export only are not yet built at government expense, though the services have recently been talked into accepting lighter cheaper frigates and submarines in the interest of "exportability".

Britain's political aspirations are linked to its defense sales efforts, but these aspirations have been a bit more modest or constrained than French aspirations in recent years. While maintaining an interest

in "autonomy", Britain has forged close political, consultative, and strategic links with the U.S. Britain's military role has been designated, despite the Falklands diversion, as covering basically the North Atlantic and Northern European theatres. Political ambitions go a bit further afield - to the Middle East for example, but the independent military production base is conceived as relevant mainly to nearby area defense. Britain also consults more frequently with NATO's leading military power than any other West European state about political matters including the implications of its arms exports. This does not mean that Britain usually seeks clearance from Washington, but that on certain occasions it may restrain its impulse to sell certain equipment, or at least check in on the implications of such sales (as in controversial areas such as the Middle East). France is more flexible in this regard, and freer of self-imposed restraints or allied pressures, as are Italy and Germany - which keeps a generally low arms export profile through collaborative and subcontracting relations. Possibly because of this flexibility, along with higher productivity and key design decisions (see footnote 10), France and Italy have surpassed British export totals.

In a sense Britain's current political controls over defense sales are negative in that they prevent sales to certain states, such as those with close Soviet ties, or those likely to damage U.K. security. It is far more difficult to find controls designed to manipulate or influence foreign regimes — or as in the context of U.S. and French sales, to win friends and influence people (both the U.S. and France also employ negative controls against specific states). Arms are used for influence still in isolated cases, such as the intimate U.K.-Omani relationship. Somewhat similar links

are also maintained with Jordan and Saudi Arabia. It is convenient for these states, as well as for Britain and the U.S., that U.K. military ties are preserved. Regionally it is less controversial for Britain to play a low profile politico-military role than for the U.S. to build an even more massive presence, despite Omani and Saudi preferences for U.S. equipment. Yet there are relatively few Omans left for Britain; few places where British bases are combined with an arms pipeline to maintain political influence.

For the most part arms flow to places that can afford, or obtain credit to pay for them. But they do not flow entirely indiscriminately. Freedman lists two main types of restrictions -- credit worthiness and security status, or wider strategic concerns. Edmonds speaks of the following criteria: effect of sales on U.K. security; impact on regional military balances; compatibility with U.K. foreign and economic policy interests; alliance or treaty commitments; and the interests of British armed forces. Foreign Office minister Douglas Hurd has listed the following constraints: (1) threats to the U.K. or NATO; (2) UN mandated embargoes; (3) special political considerations such as opposition of other states to sales; and in some cases (4) considerations of regional stability and introduction of new technologies in regions; (5) nature of equipment and its possible uses; (6) human rights considerations; (7) needs to safegard U.K. dependencies; (8) multilateral arms control implications. British weapons sales to certain countries are now or have previously been prohibited: South Africa, Taiwan, and

since the Falklands and Lebanese crises, Argentina and Israel are the only recent cases. Yet despite the UN embargo of South Africa, U.K. defense goods get through if they are classed as having dual civil and military communications applications and can be put on a special "C" list of Commonwealth goods (for which even NATO states would need a license). Taiwan's ban is based on political and commercial ambitions vis-à-vis Peking, which itself was exempted from normal COCOM (Coordinating Committee on Export Controls) restrictions. Thus, as with most arms suppliers' controls, loopholes and provisions for selective application are evident.[22]

Of all the restraint criteria listed above, the U.K. security question -- the worry that weapons will be used against British interests -- seems the most pressing. Yet even in light of these worries Britain has gone ahead with sales of certain less lethal systems to Iraq, Libya, and Central America (where Guatemala's threat to Belize remains a problem for London). Commercial interests are difficult to resist, and it is also difficult accurately to assess regional power balances. Definitions can serve political interests. Most civil servants today fall back on a rather commercially convenient dictum that Israel is so far ahead of the Arabs (presumably thanks to U.S. supplies), that there is little danger in selling large quantities to Arab states, despite the potential of such supplies for fueling disastrous wars such as Iraq's, with Jordanian and Gulf states' support, against Iran. Although the general U.K., and especially Foreign Office policy is not to sell to states in ongoing disputes, this is subject to reinterpretation and to evasion through third party transfers.

Related to U.K. security is the release of sensitive information or technology. Weapons systems can sometimes be modified through inter-ministerial consultation to remove ultra-sophisticated devices. The MOD, concerned lest sophisticated devices fall into the hands of "Soviet penetrated" regimes, keeps a list of countries which cannot receive various levels of technology, so the weapon system can be matched to the recipient. This has been an embarrassing problem in negotiations with India in recent years. The Foreign Office is concerned about security as well, and has maintained a form of matrix in which countries are matched to types of weapon and to control criteria:

> "Our advice is always sought and we give advice as regards the country, the type of weapon and the scale and duration of supply. We do not regard it as part of the job of the FCO to cover commercial matters or the details of a contract". 23

Geographical departments in FCO may review the initial release of information by companies pursuing sales, and then again consider the ultimate technology in the final weapon sale.

Obviously, British, French, American, German and Italian arms sales to the same region could exacerbate conflict, nullify attempts at regional balance, and conflict with ultimate NATO security interests. Yet there is remarkably little coordination among the allies; spokesmen refer to arms transfers as a keenly competitive business. NATO arms transfer coordination is probably greatest between the U.K. and U.S., and where strategic concerns are heightened, as in the Persian Gulf. There has been much less consultation regarding Latin America or Asia.

Both for commercial rationalization and political coordination, marketing agreements between NATO allies have sometimes been proposed, but British officials have generally taken a dim view, maintaining that NATO, with a strictly North Atlantic purview, has no obligation or authority to coordinate restraint of sales to other areas:

> "... at the moment ... there are no foreign policy considerations in the minds of any of the allied governments which would in principle prevent the supply of arms; ... if one is thinking about Saudi Arabia or the Gulf countries or Oman or, indeed, about many other parts of the third world, we are in a position where none of the allies, and quite rightly in my view, feels that it would be right for them to prevent their suppliers supplying." 24

This reflects British assumptions that they still can and must compete in a variety of weapons categories, that U.K.-U.S. strategic coordination is sufficient, and that it would be a mistake to become dependent on single suppliers -- the U.S. for example in fighter planes -- for NATO arms capabilities.

Notable disagreements have sometimes arisen between the two main ministries concerned with political control. Some in the Foreign Office still recall with dismay "excesses" of the Defence Sales Organization and its commercial sales arm, IMS, during the multifarious and lucrative deals with Iran during the mid- to late-1970s. Blindfire and Rapier radar and anti-aircraft missile systems evidently were sold despite what were considered to be potential COCOM regulation conflicts (potential Iranian instability and Soviet penetration). Evidently as well, FCO was not consulted when Sir Ronald Ellis, then the Head of Defence Sales, concluded

an approximately £1-billion deal for an Iranian military installation during a personal meeting with the Shah, agreeing to accept payment for the project in oil. This was at precisely the time British North Sea oil was coming on-stream, and with prospects for an oil glut.[25]

Occasionally the Defence Sales Organization has ventured to evaluate the impact of arms exports on political stability abroad. While few formal and systematic attempts are made to calculate regional consequences or balance of power impacts, public pronouncements have sometimes made evaluations sound (unaccountably) systematic:

> "... Something like 96 percent of the stuff we supplied has never been used in anger, and I think that, from a political point of view, is excellent. We have produced export business, we have developed a technological base which can go into civilian production ... and yet we have not been involved, except with that 4 percent, in actual conflict. The equipment has been used for training or running around in the desert but not to shoot anybody." 26

One way of assessing the efficiency of political controls and extent of restraint is to look at license refusals or refusals to sell. Lord Strathcona, a Minister of State of MOD, has listed the following refusals: Uganda under Amin; the PLO; Argentina (civilian control equipment usable in torture); Iran (temporary hold on spare parts during U.S. hostage dispute -- with willingness to supply spares at other times); and South Africa (exceptions noted above).[27] By contrast, in view of Afghanistan, Britain felt more entitled to sell to Pakistan, subject to financing; despite human rights violations, Indonesia and Turkey (which lacked funds to purchase arms) as well as Singapore, would be

allowed to buy equipment because of established good relations and/or alliance ties. This was a retreat from previous statements that no sales would be made to states guilty of torture.[28] Many of the refusals listed related to terrorism and IRA access to weapons. While commercial considerations predominate in most U.K. arms exports, clearly political relationships still play a role -- as in Turkey's ease of access.

The Economic Control Factor

The Ministry of Defence and Defence Sales Organization have evolved a rather complex set of relations with both nationalized and private industry. As noted earlier, the DSO is seen as representing defense contractors' interests in government and now has representatives on all the main procurement committees.[29] The DSO automatically becomes a party to government-to-government understandings and agreements on defense exports, and sells ROF goods directly. It has now evolved an indirect "arms length" role in putting together packages of sales and services and in arranging agents' commissions through the MOD owned (except for one share held by the Treasury) but commercially independent IMS Ltd operation. A division of DSO also coordinates Britain's role in collaborative international defense projects (e.g., Tornado aircraft) and sales. IMS purchases of ROF equipment allow indirect export credit for ROF's as well; the equipment is exported through IMS.

Through such arrangements, MOD is able to keep a low profile in sales, allowing companies and the Export Credit Guarantee Department to arrange financing and engineer contract terms abroad. Thus, DSO and MOD

are kept fully aware of impending deals, and can strongly affect the final form of contract arrangements if desired. Yet as seen below, the MOD comes under certain pressures because of government involvements in both ownership and marketing of ROF goods, because of responsibility for IMS, and because of close relations with private industry. These pressures tend to undermine or reverse the control process.

Nationalized Industries

British nationalized defense industries operate in much the same way as private commercial ventures. The relevant government ministry (formal owner) appoints a board of directors which is allowed commercial autonomy, but is kept responsible to government boards. If the nationalized firm is a limited company under the Companies Act, it can also compete for funds on private financial markets as well as making limited, though potentially significant demands on the Treasury. Operating boards can disobey their ministerial bosses, but risk dismissal as would any corporate board disobeying stock-holders.

In general, British nationalizations in the defense sector have been related to Labour Party ideology and to issues of economic "rationalization." Part of the ideology has been to harness industry to public interests and assure control over industry and investment priorities. Concern for rationalization has been most pressing in aero-

space and shipbuilding. By the 1960s and 70s it was apparent that the British market could no longer support the variety of aircraft manufacturers that existed prior to World War II. Beginning around 1960, the government began forcing consolidation, by refusing to award contracts to single manufacturers (e.g., the TSR-2 project). Finally, in the late 1970s the last of the larger privately merged aircraft corporations was integrated into wholly government owned British Aerospace Ltd. (BAe). Economic stringency has more recently moved the Conservative Government in the opposite direction, toward sales of British Aerospace shares and privatisation. Helicopter production remained in private hands, with Westland's near monopoly. British Shipbuilders were only finally consolidated in the late 70s. The structure of the nationalized British defense industry, therefore, is hardly competitive.

Conservatives have, of course tended to criticize nationalizations ideologically, but they have also questioned whether in fact nationalization has produced greater government control over defense sales.

> "The reality ... is that 'public accountability' in the sense of reporting to Parliament, actually decreases after nationalization, with the cessation of direct ministerial responsibility." 30

We have already noted a certain "hands off" stance by the British Government in the sales business, applying even to the nationalized sector. Ministries can retain formal ownership of and supervisory directorship of manufacturers, and yet leave them to their own commercial operations. Ministries might even avoid having to report to Parliament through means such as partial privatisation or creation of quasi-non-governmental

(QUANGO) affiliates. The obverse is also true, in the sense that ministries can have considerable control both of government and privately owned enterprises if they want to, through procurement decisions, licensing of systems and subsystems, subsidies, and legislative proposals. On the whole, nationalization leaves firms approximately where they were under private ownership in terms of government regulation; where the difference matters may be in potential for added business control over government.

In terms of potential control, the government could prevent nationalized firms' commercial decisions which were considered contrary to the national interest -- such as a decision to close ROF factories and increase unemployment in Leeds, for instance. Often, however, the choice involves not so much government fiat as willingness to throw added funds from the Treasury into the bargain, as in keeping an unproductive plant open longer. Increasingly, the same choice is also presented by private firms seeking subsidies, government purchase commitments, or tax benefits. With major defense systems costing ever-more to research and produce, private and public firms alike want greater government financial participation and guarantees, although of course less government regulation as well.

Therefore, whether a company is public or private -- and BAe in a sense is both -- management imperatives these days relate to a cat-and-mouse game with government agencies -- trying to elicit financial commitments, yet retain design initiative so that export features can

be built in (the Chairman of BAe has estimated that two-thirds of the production of the proposed P110 fighter would have to be exported to make it commercially viable). Government, on the other hand, tries to maintain only limited financial liability while guaranteeing control of design specifications.[31] This leaves "exportability" features open to negotiation and compromise. The Thatcher Government's joint venture concept (i.e., often 50-50 government-company funding) and the general search for funds may also encourage international collaborative projects, despite problems with such projects such as production delays, varying levels of commitment, and nationalistic insistence (rather than technologically rational decisions) on producing certain parts of systems.

The Royal Ordinance Factories' Trading Fund illustrates the semi-independent financial status accorded British nationalized defense industries. While the Thatcher Government has toyed with privatisation of even these traditionally wholly public enterprises, their relatively poor profit showing has reduced the number of interested investors, and they remain HMG's responsibility.[32] ROF sales overseas sales are financed by an MOD supervised trading fund rather than by monies from the defense budget ("votes"). Due to "cash flow" problems, however, votes have sometimes been used to purchase equipment, store it, and sell later to foreign customers. The trade fund is a reserve of export revenue from which future sales can be engineered and supported. The ROF's may borrow from a National Loans Fund to replenish the Trade Fund if cash flow problems occur, and profits beyond immediate reinvestment needs are to be repaid to the Treasury which provided seed money for the Trade Fund.[33]

Clearly then, the British form of nationalization subjects the government to increased potential financial responsibility for industry losses, as well as affording some potential financial gain, and no apparent increase of control over management decisions. Potential for control is there, but is offset by a desire to maintain distance from commercial hurly-burly (embarrassing payments to foreign agents, for example). In the words of Minister of State at MOD, Sir Frank Cooper,

> "I think that "arm's length" is a rather wonderful phrase, really. I think that I accept it so long as it is my interpretation of what arm's length is."

Maintaining that it would be impossible totally "to get the risk off votes", Sir Frank justified the type of "ex-gratia" payment to MOD from the ROF 1977-78 Trade Fund accounts (evidently prefunded Iranian money) as part of the "living partnership" between the two bodies. MOD takes

design risks, makes ROF's the preferred source for MOD supplies, stands behind both ROF's and IMS to cover bad debts (ROF's as a public body cannot directly obtain ECGD cover, although IMS, as a limited company can). MOD will be charged for anything that goes wrong with the design, so if contracts (such as Iran's) turn out to be more profitable than expected, in return MOD should have an extra slice of the benefits.[34] As ultimate owners, the MOD is in a position to extract, along with the Treasury, a greater share of profits if profits seem likely; however, the loss side of the ledger lately has loomed larger in the minds of those in Whitehall as they try to disengage from ownership responsibilities.[35]

Both ROF's and British Shipbuilders (BS) have opposed privatisation because they see certain advantages in continued government ownership. Although nationalization does not prevent government project cancellations, the Defence and Industry (DOI) Ministries are somewhat more obliged to lobby at top level for restorations. The DSO and DOI can even be useful in finding ways around Export Credit Guarantee Department limits by pushing for "national interest" classification of particular sales.

Particularly in shipbuilding there is far from a global free market, with many governments heavily subsidizing their manufacturers and thus offsetting each other's efforts and advantages. The U.K. invested £412m

in BS during 1980-81, including £165m from an intervention fund to meet foreign competitors' prices. Reasonable credit terms of 8-10% over 8 years are also available through government subsidy of financial lenders. Yet the results in overseas sales are far from encouraging. In a sale of patrol boats to Hong Kong, with MOD picking up 25% of the cost, over-sophistication of design and cost overruns led to the prospect of HMG picking up 25% of a £50m bill -- over 50% more than expected. In addition the boats were judged too sophisticated and costly to be sold elsewhere.[36] HMG's investments in such undertakings are certainly subject to question, although the basic management problems of British industry (productivity, foreign competition) and potential solutions have relatively little to do with the question of government vs. private ownership, and are unlikely to be solved by de-nationalization.

The QUANGO Solution

Officially the Thatcher government took a dim view of quasi-non-governmental organizations in the British economy, considering them only nominally free of the sins of nationalization. Yet in the defense field, little has been done to expiate the sins. As indicated above, the beauty of IMS from the government perspective is the chance to control the pace and characteristics of complex sales and service packages, bringing together the resources of a number of British and foreign contractors, without actually being identified as a party to the sale. IMS is also able to acquire export credit (ECGD) backing and compete for private financing -- it is "commercially flexible". In the felicitous phrasing of Permanent Secretary Sir Frank Cooper, "... we always wanted to see

IMS at arms-length from the Ministry of Defence, behaving commercially and as commercially as it possibly could."[37]

International Military Services grew from the tradition and indeed the operations of the Crown Agents, individual civil servants who provided all necessary goods for over 100 years to British colonial governors. When Commonwealth governments wanted to keep sûpplies coming, it was necessary to nationalize parts of the operation since individuals could not form legal contracts with foreign governments. Millbank Technical Services (MTS) was designated to handle military sales to Iran at the Shah's request (he had heard of MTS almost by accident, probably from Jordan or Saudi Arabia, where Britain had outfitted the air force). After a record of shoddy performance, MTS was taken over by MOD and reformed as IMS. IMS brought together groups of contractors in package deals and cut down on unnecessary middlemen and their 20% commissions. This would increase the Shah's control over what was delivered, and guarantee U.K. government efforts to rectify anything that went wrong.

With the Shah's fall, IMS was given control of all ROF non-NATO sales. A new trading agreement was worked out between IMS and ROF's to share business costs and have IMS market the production. The MOD was not a party to this agreement, the future of which depends on ROF privatisation. IMS also sought to move more heavily into the military <u>construction</u> business, with its experience building Iranian naval bases and military (tank) production facilities. It has continued to concentrate on Middle Eastern ties, along with African, and (somewhat less) Latin

American activity. The joint and high level forces of IMS, ROF's, and DSO worked to obtain the Jordanian commitment to purchase some of the Shir tanks refused by Iran when the Shah fell. The ECGD repaid much of the Iranian construction losses for contracts that were not prefunded, thereby transferring the QUANGO's bad debts to another government department (of course, IMS had to pay ECGD for the credit insurance premiums). IMS does not technically operate a trade fund, though its reserves and the percentage owed the Treasury resemble one. If prepayment comes to IMS from the customer on an MOD financed deal (ROF's), then it is immediately turned over to MOD; if it is a separate IMS arranged deal, the prepayment if held and invested by IMS. Since it is not covered by the Trade Fund Act, however, all decisions on financial recovery must be formally negotiated between Treasury, MOD and IMS.

In a sense the MOD has tried for the best of both worlds -- government control without too much responsibility -- through IMS. Yet it is difficult to determine whether the best or worst has been achieved. For example, IMS tries to assure that contracting companies ntracting companies comply with MOD requirements without any need for direct MOD contact with the companies. However, MOD is also pledged to assist IMS to obtain business, to make monies available to cover IMS <u>and</u> contractors' losses or claims against them, and to assist with cash flow until insurance repays the losses. MOD will consult about indemnifying IMS if asking it to undertake business IMS considers commercially unacceptable, and will consult on providing more money if IMS reserves are "barely adequate" (as they seemed after Iran). Periodically, MOD has tried to

move IMS off votes and push for greater IMS reserves. Nevertheless, MOD can make limited monies available to IMS on short notice, even in advance of parliamentary votes.[38] Despite arm's length, therefore, the British government is directly implicated in defense related exports, and heavily committed financially to support them.

Private Companies and Export Credit

Government is also involved in the private sector's defense exports, both as initial and main procurer of defense equipment, and in underwriting sales and research (much of which is conducted in government R & D establishments). This can increase the direct cost to the government of defense sales. Industrial leaders emphasize the need for MOD to "buy British," so that foreign customers have an implied stamp of approval and so that production runs can be guaranteed. Yet if "buy British" means to eschew the purchase of cheaper foreign equipment, the government is being asked to pay a premium so that firms can export more. The premium may be worthwhile politically in terms of military "self-sufficiency," British jobs and manufacturing potential, and exports do bring revenue to the government through repayment levies for research and development subsidies; the costs are not readily apparent to the public. Industrial leaders also call for governmental assistance in sales, to open doors to the right people in foreign governments, and to select and back the British firm most likely to succeed in winning the order (the French model).[39]

Yet in practice, some British executives, especially those in the

more competitive electronics firms, also say that they have sufficient marketing talent and connections of their own, and prefer to be able to compete for export markets rather than have them parcelled out. They do, however, want the military to relent and accept more exportable products with perhaps lower standards. Some see themselves as producing essentially two product lines, with separate design and production teams, one for the British government (and whomever else will buy), and another for more marketable private export ventures.[40] However, the exportability problem is not quite so simple; in naval equipment British standards may be above foreign customers' needs (though the light materials used in frigates sunk near the Falklands Islands lead one to question the supposed over-sturdiness of naval designs), but foreign buyers often demand very highly sophisticated infantry equipment -- sometimes more than that demanded by British services or more than HMG is willing to release. Businessmen seem to view military priorities in procurement as excuses about "their role," a role no longer (at least until the Falklands crisis) taken very seriously. As one executive put it, as long as a system works well, i.e., kills Russians, it does not have to be the best.[41]

Executives of the largest private firms sit on the National Defence Coordinating Council and also on the newly established Procurement Executive policy committee, along with representatives of MOD, FCO, and the Department of Industry on certain occasions. Government-corporate dialogue concerns such matters as amount of government funds available, government resistance to performance bonds sometimes requested by

customers dealing with private firms, percentage of allowable profit, R and D support and recoverable R and D levies. The government seldom sees company price and profit calculations, however.

The plethora of smaller subcontractors and component manufacturers also have a voice in government, and one that may soon be included on the two highest councils. The Defence Manufacturers Association (DMA) was formed in the late 1970s to represent them (though it has only about 300 members). The DMA tries to ease government regulations and procurement requirements, and supports the carryover of defense budget funds from year to year. Making systems more flexible for saleability -- such as producing tanks as platforms upon which more or less sophisticated equipment can be mounted -- is a prime concern. Furthermore, subcontractors argue that they should be protected by government regulations from the whims of main system contractors (issues such as payment terms and R & D subsidies for subsystems).

Finally, export credits represent an additional means of government control of and responsibility for arms deals. The Export Credit Guarantee Department (ECGD) is basically a government insurance agency providing either credit backing to the customer country in a civil or military trade agreement, or to the exporting company to cover against customer default. ECGD works with London or foreign banks (US and Japanese) to obtain buyer credit in sales agreements, and must clear its commitments to the banks with the Treasury in larger sales. ECGD itself issues insurance coverage for the exporter against defaults, charging a premium

and attempting to spread the risk over a large business volume, as any other insurer would. Organization of Economic Cooperation and Development (OECD) rules on credit limits and terms are followed in arranging buyer credit; the OECD generally considers arms deals more risky than other forms of trade, although ECGD experience suggests this is not the case.

ECGD refers to its rating of foreign countries' credit worthiness (the same rating for civilian and military sales). Well developed states are generally rated near the top -- including the Communist countries (except Poland) which have normally paid their bills religiously -- and LDC's nearer the bottom.[42] In the past few years, political instability (especially Iran) has led to increased claims and a net loss from ECGD reserves. Unlike US FMS or French COFACE credit arrangements, there is no direct financing by ECGD. The exporting firm takes a loan with a bank (ECGD consulting), and the bank is insured by ECGD for 100% of risk; the exporter is covered for 90% of risk. If the exporter fails to deliver the goods, it must repay the loan; ECGD analyzes the exporter's reliability, and examines the terms of contracts and buyers' loan terms, looking for termination clauses, arbitration clauses, and payment arrangements. Exporter's ability to deliver is also investigated if credit is going to the buyer.[43] ECGD even covers the risk that export licenses will be cancelled by other government departments.

ECGD officials meet regularly with their counterparts in OECD, and exchange quite accurate information on the credit terms being used by

each country, even in pending deals. In this way, buyers cannot easily play one country off against another in bargaining for credit. Countries, such as Germany, which will not officially finance arms purchases and rely on private financing, attend these meetings and participate as well.

Credit coverage in collaborative deals can be quite complicated. In UK-French Jaguar sales, a buyer could receive U.K. but not French credit (Dassualt Aircraft pushed Mirage sales), yet exporters (British Aerospace) could obtain credit from France. ECGD would not cover the buyer credit France denied, but would facilitate reinsurance for the supplier -- which can be passed on to the buyer. As long as British Aerospace were responsible for the loan, French COFACE would back it.[44]

Credit is provided on a first-come first-served basis, and companies compete to get in under the yearly credit limit. Each contract is covered separately, so ECGD can be responsible for covered losses in one deal even if other deals by the same company are returning profits. Credit insurance is also a way for companies to ease the impact of fixed price government contracts. They can insure themselves against unforeseen cost increases. In this sense and as noted above, ECGD is both a means for government to facilitate and restrain weapons sales, and for companies to financially weather controls by other government departments.

Conclusion

The British government is hampered in applying political and economic controls to arms transfers, i.e., linking transfers to foreign policy, arms control, or commercial and fiscal goals. Control is limited by deep government interests in sales and defense industry production (and ownership). The clearest criterion for control is release of sophisticated equipment and U.K. security interests. An item such as Rapier anti-aircraft missiles has been released mainly to NATO allies, and advanced industrial states such as Japan, Australia, and Switzerland. Yet as the years pass, restrictions ease, and in the case of Rapier, controls break down early to the extent that potential Third World troublespots such as Iran, Abu Dhabi, Kenya, and Brunei obtained access. While London turned down certain Iranian and Iraqi requests for supplies during their recent war, British equipment, such as tank recovery vehicles, evidently was sent to Iraq through Jordan and/or the Arab Gulf states. It is questionable whether U.K. foreign policy interests have been served by Iraq's abortive attack on Iran.

While selective restraints on sales have been imposed by various U.K. governments, as with most of todays arms exporting states, loopholes abound and long term and comprehensive limits are eroded. The reverse influence exercised in favor of arms transfers by nationalized,

semi-national, and private business interests, as well as by a government agency charged with promoting sales, contributes to the erosion.

There is in fact a severe divergence between control of foreign policy and control of defense sales in the British government. The Foreign Office plays a distinctly secondary and reactive role in decisions to promote or proceed with sales . Unlike its American counterpart, the FCO seldom if ever initiates a sale proposal and is not the main clearing house for obtaining inter-ministerial approval or comments on sales. Although the Falklands dispute dragged on for over 17 years, and was frequently mentioned as an issue for arms sales control, the main evident limit on arms sales to Argentina concerned human rights questions rather than strategic defense.

While the government has strong commercial interests in arms exports, its main motivations - as defined through the Defence Ministry - seem to be in maintaining production lines, a semi-strategic interest. In the process, it has determined to promote sales, but to do so in the least evidently commercial way, i.e., at "arm's length" through semi-autonomous governmental enterprises, QUANGO's, and subsidies.

It is noteworthy that these involvements have not notably enhanced government's ability to link defense sales either to political, military (procurement), or economic policy. Britain remains intent on a high degree of military self-sufficiency, and yet the military is asked increasingly to tailor their weapons designs to export criteria. Britain retains political interests in regional stability particularly in the

Middle East, Asia, and Latin America, yet the quest for exports has helped fuel wars in the Persian Gulf and South Atlantic which materially threaten British interests. In the past, IMS has supplied participants in the Algeria-Morocco, Tanzania-Uganda, and Iran-Iraq fighting. Economically, the government subsidizes marginally (at best) profitable operations in ship, tank, and aircraft production and suffers increasing problems of default on arms sales payments (ECGD losses) and cash shortfall in its own procurement. Growth in arms sales revenues has been sporadic especially in relation to cost and inflation. Judged by government figures, the employment benefit of defense sales is relatively low.

This leaves the question of whether a medium sized state with profound economic problems and shrinking global involvements (or a basically one-theater military role) should be in the arms sales business. Entailed are the related questions of whether such a government should own its arms producing facilities, should adopt a direct, or an arm's length but intensive interest in sales, or should leave sales strictly to private manufacturers which prove themselves competitive and export under government license. In the British case, nationalization and, arguably, rationalization of defense industries have not resulted in spectacularly higher sales, clearly better equipment, more socially productive investment decisions, or a better alignment of defense sales and foreign policy interests. Privatising existing enterprises would hardly solve basic productivity and technology problems either, although it might lessen government's spending responsibilities.

Evidently lacking is an overall plan for arms sales and politico -

economic policy, comprising the long term effects of various force postures, military production formats,and arms export restrictions, on British overseas political interests and ability to defend key interests in conjunction with NATO. Such a plan might calculate the budgetary and political benefits and costs of various options - such as importing rather than manufacturing key weapons systems, exporting only certain types of equipment (according to economic competitiveness or regional military impact) to certain regions and in certain circumstances (excluding regional warfare, for example), participating in more or less joint international arms production, subsidizing only the most efficient manufacturers of the most necessary equipment, reducing government undertakings to stand behind weapons sales unless such sales served immediate and demonstrable foreign policy interests, and increasing efforts, including international efforts, to control or at least account for end-use. A plan of this sort need not conflict with basic policies necessary to sell weapons overseas - such as a commitment to honor existing contracts and supply spare parts unless vitally pressing legal or political concerns (e.g., UN embargoes) force license revocation. It could inspire more precise definitions and rules which would more predictably regulate and derive greater social benefits from defense sales.

TABLE 1a

U.K. Defense Sales - Various Estimates*

	1967-7	67-8	68-9	69-0	70-71	71-2	72-3	73-4	74-5	75-6	76-7	77-8	78-9	79-0	80-1	
£m	152	165	214	227	235	242	257	425	468	530	600	790	901[1]			Current £
£m									477	537	777	1070	1075	1200	1500[2]	Current £
£m					870			1230						1040[3]		Constant £
£m		509	609	632	609	570	564	860	792	700	708[4]					Constant 1976
$m			324	123	264	663	801	671	584	820	950	1024[5]				Constant 1977
$m			348	185	393	369	316	579	647	587	680[6]					Constant 1975
$m							360	450	410	530	720	1020	770	600[7]		To Third World Current $

1. Defence Estimates and Hansard, 6 December 1976 and 14th March 1977 (Estimates of deliveries, derived from Customs and Excise Tariff figures at f.o.b. prices, excluding aircraft).
2. Defence Estimates, April 1981 (Estimates of deliveries, adding aircraft and other items after 1979; valued by Customs and Excise)
3. Lord Orr-Ewing, Debate on "Defence Equipment: Policy on Overseas Sales", House of Lords, Hansard (March 1980; unspecified as to comparison of totals, though purported to include arms and services in 1979-80).
4. M.O.D. Data compiled by Mary Kaldor, University of Sussex, 1977 (unspecified as to composition of totals; estimates likely to have been based on Customs and Excise figures).
5. ACDA (US, 1980) (Deliveries, valued according to estimated production cost and use value of conventional equipment, includi weapons and dual purpose equipment parts, ammunition, support equipment and defense industry infrastructure, but excluding construction, training, and technical services).
6. SIPRI (Deliveries, valued according to estimates of trade value and indexes, of major weapons (aircraft, missiles, armored vehicles, and warships), aircraft spares, transports, trainers, and licensed production agreements).
7. U.S. Government on 3rd World, 1981. (Probably CIA estimates of deliveries valued according to estimated production cost and use value).

* For a recent discussion of the complexities of estimating arms transfer values, see Michael Brzoska, "Arms Transfer Data Sources," Journal of Conflict Resolution, 26 (March 1982), pp.39-75.

Table 1b

Number of Overseas Defense Sales Contracts and Number Valued at Over £1 million

	1976	1977	1978	1979	1980
Total	186	150	123	195	287
Over £1m.	79	69	71	69	116
(%)	(42%)	(46%)	(58%)	(35%)	(40%)

Source: Hansard, House of Commons (July 21, 1981).

TABLE 2a

Breakdown of U.K. Arms Sales by Area or Region (Millions of £, Current)

TO:	1966-75	1973-77[1]	1975[2]	1976	1977	1978	1979	1980
Third World		2465 (76%)						
Developed World		770 (24%)						
NATO	25%	570 (18%)	52 (26%)[3]	43 (20%)	48 (13%)	77 (20%)	82 (21%)	111 (21%)
OPEC	36%	1215 (38%)						
NATO Europe		220 (7%)						
Other Europe	3%	65 (2%)						
North America		350 (11%)						
E. Asia	6%	390 (12%)	20 (4%)	12 (6%)	19 (5%)	46 (12%)	63 (16%)	134 (25%)
South Asia	4%	65 (2%)						
Africa	9%	180 (6%)	5 (3%)	12 (6%)	10 (3%)	18 (5%)	36 (9%)	121 (23%)
Middle East	33%	1280 (40%)	91 (46%)	128 (59%)	162 (46%)	202 (52%)	127 (32%)	158 (29%)
Latin America	14%	565 (17%)	30 (15%)	23 (11%)	117 (33%)	49 (13%)	85 (22%)	13 (2%)

1. Figures compiled by U.S. Arms Control and Disarmament Agency.
2. Figures in MOD Statement on Defence Expenditures, 1981 (Vol. 2), p.21.
   Regions here are defined as: NATO and other Western Europe
   Middle East and North Africa
   Sub-Saharan Africa
   Latin America and Caribbean
   Asia and Far East
3. Percentages of Customs and Excise Identified Equipment - excluding aircraft.

TABLE 2b

Defense Sale by Regions

	Sales Destinations (1979)[1] (Countries)	Number of Negotiated or Agreed Contracts and Orders (1981)[2]	U.K. Rank on Regional Arms Sales 1973 - 1977[3]
MIDDLE EAST	13	39	4
W. EUR.	13	38	7 (5)
N. AMER.	2	47	2
L. AMER.	10		3
ASIA	10	19	4
S. S. AFR.	11	16	6
PACIF.	2	14	-
E. EUR - USSR	0	1	-
NATO	-	-	3

1. Hansard, House of Commons (April 15th, 1980).
2. Contract listings from late 1980 compiled by the Committee Against the Arms Trade
3. Regions defined as: Europe and NATO Europe in parentheses; NATO; East Asia; Middle East; Africa; North America; Latina America.

TABLE 3

Type of Equipment Exported

% of Total UK Defense Equipment Exports (£ million - current)

	1975	1976	1977	1978	1979	1980
Ground + Spares + Ammo	21%	23%	18%	27%	25%	18%
Air + Spares	68%	67%	62%	47%	45%	-
Sea + Spares	9%	7%	16%	4%	8%	5%
Missiles	3%	3%	3%	2%	2%	2%
Special Electronics and Training Equipment	-	-	-	20%	19%	-

Growth Rate from Prior Year

Ground	22%	17%	99%	-5%	19%
Air	12%	34%	5%	-4%	-
Sea	-14%	242%	-68%	110%	-28%
Missiles	38%	50%	-1%	0%	4%
Electronics and Training	-	-	-	-3%	-

Source: MOD Statement on Defence Estimates 1981 (Vol. 2) p.26.

TABLE 4

Export Revenue as % of Costs

a. As % of Gross R & D Expenditure (using latter export revenue year)

				Est.	Est.
76-77	77-78	78-79	79-80	80-81	81-82
98%	101%	100%	89%	96%	-

b. As % of Gross Defense Production Expenditures

Total	39.5%	46.6%	40.2%	38.9%	39%	-
Land	24.7%	41.2%* (28.1%)	38.5% (25.7%)	27.3%	-	-
Sea	20.8%	5.8%	10%	5.9%	-	-
Air	72.9%	63.6%	48.7%	-	-	-

* Road vehicles suddenly included

Source: Ministry of Defence, Statement on the Defence Estimates 1981, Vol. 2, pp. 21 and 24-25.

FOOTNOTES

1. John Stanley and Maurice Pearton, The International Trade in Arms (London: Chatt and Windus, 1972).

2. The phrase appears in a draft of a forthcoming volume on transfers and public accountability. See also, Martin Edmonds, "The Domestic and International Dimensions of British Arms Sales, 1966-1978," and Mike Dillon "Arms Transfers and the Federal Republic of Germany," in The Gun Merchants : Politics and Policies of the Major Arms Suppliers, ed. by Cindy Cannizzo (New York: Pergamon Press, 1980), Chs. 4 and 5.

3. Information on procedures comes mainly from a document issued by the Ministry of Defence, "Procedures Used by Her Majesty's Government in Reaching Arms Sales Decisions," (1978); from Edmonds, op.cit.; from the author's confidential interviews with representatives of U.K. government agencies and defense contractors in late 1981 and early 1982, and from publications by and about DSO.

4. All exports from or trans-shipment through Britain of defense equipment defined as arms, ammunition, military stores, para-military police equipment, and as having dual military-civilian uses must, by law, be licensed by the Department of Trade. The license is valid for 12 months, and can be renewed, usually with little controversy. Exports by nationalized defense industries, while not formally licensed, are subject to the same license review procedure, including consideration by the Foreign and Commonwealth Office of political implications, by MOD of security and strategic implications, both for British forces and abroad, and by the Treasury and/or Export Credit Guarantee Department in the Department of Industry if financing or credit guarantees are required.

5. Testimony by Douglas Hurd, M.P., before House of Commons Foreign Affairs Committee, Session 1980-81, Overseas Arms Sales : Foreign Policy Aspects (March 4, 1981).

6. Sole use, meaning that the equipment will not be passed on by the customer without prior consultation of MOD, is a provision of all government-to-government contracts, while private firms often but not invariably include similar understandings in contracts. The government tries to include them as well in MOU's backing private deals.

7. Edmonds, op.cit.

8. On data ambiguities, see Edmonds, op.cit.

9. See, for example, The Financial Times (London), June 24, 1980. Lawrence Freedman indicates, however, that M.O.D. figures may understate

9. (cont.)

the value of exports. London stockbrokers noted arms sales 57% higher than reported government figures in 1975. See Lawrence Freedman, Arms Production in the United Kingdom : Problems and Prospects (London: Royal Institute for International Affairs, 1978), fn.36.

10. It is difficult to account fully for France's apparently greater sales success. British officials and academicians tend to attribute it to unflagging French governmental support, and export-oriented defense procurement policies, to greater willingness to conclude politically controversial sales and offer France as an alternative to reliance on superpowers, to liberal credit terms and promises of uninterrupted resupply even in wartime. However, a look at industrial performance and manufacturing productivity in recent years also shows France with the fastest growth in both output and available capital, roughly twice the U.K. growth rate (the lowest on aggregate among major European countries, North America, and Japan). Such performance should ultimately affect exports of industrial goods including arms. See J. P. Stein and Allen D. Lee, Productivity Growth in Industrialized Countries at the Sectoral Level, 1963-1974 (Santa Monica, Ca.: Rand, July 1977).

11. Data for these admittedly rough calculations came from the U.S. Arms Control and Disarmament Agency (1973-77), Hansards (1979), and the Committee Against the Arms Trade (1980-81).

12. See Hurd, op.cit.; and the Financial Times (June 24, 1980).

13. Freedman, op.cit., p.29.

14. Mary Kaldor, Defence Industries -- National and International Implications (Sussex: Unpublished manuscript, 1972); this finding has been corroborated as well by A. J. Alexander, W. P. Butz, and M. D. Mihalka, Modeling the Production and International Trade of Arms : An Economic Framework for Analyzing Policy Alternatives (Santa Monica, CA.: Rand Series in International Security and Arms Control, March, 1981).

15. "Editorial," Engineering Today, February 15, 1979.

16. One industry estimate for British military airframes posits an "85% learning curve", with each doubling of production volume reducing manhours required (direct labor costs) by 15%. This translates roughly to an 8-10% reduction in unit costs as production is doubled. Significant cost reductions can therefore be realized at between 200 and 400 units or less. While British domestic procurement of fighter aircraft in the past seldom exceeded 100 units, new jointly produced Tornado fighter sales in the producing states (Germany, Britain, and Italy) were likely

16. (cont.)

to exceed 250 units even with defense budget stringency and cost overruns. Collaborative production tends to raise unit costs somewhat, though. The U.S. with military aircraft domestic procurements three times as large as the U.K., enjoys a unit cost advantage, and Britain has tried joint projects, government subsidy, and export sales promotion as means to compete. One alternate means has been suggested: to open U.K. procurement to more competitive bidding from abroad and from international collaborative projects, thereby increasing competition for U.K. firms and forcing more productivity and lower costs. On learning curves see Keith Hartley, A Market for Aircraft, Hobart Paper 57, (London: The Institute of Economic Affairs, 1974), esp. pp.18-22; and J. P. Large, et.al., Production Rate and Production Cost (Santa Monica, CA.: Rand, December 1974), Parametric Equations for Estimating Aircraft Airframe Costs (Rand, February 1976), A Critique of Aircraft Airframe Cost Models (Rand, September 1977), and Estimated Costs of Extended Low-Rate Airframe Production (Rand, March 1978).

17. Trevor Taylor, "Research Note : British Arms Exports and R & D Costs," Survival, 22 (Nov/Dec. 1980), p.259.

18. Andrew J. Pierre, The Global Politics of Arms Sales (Princeton, New Jersey: Princeton University Press, 1982), pp. 101-102; SIPRI Yearbook (1980); Freedman, op. cit., p. 29.

19. Edmonds, op.cit., pp.71 - 76.

20. In selling arms widely the French clearly pursue political influence as well as revenue. They have professed to offer an alternative to dependence on one or both superpowers, and they have tailored their marketing emphases to those regions - Africa, the Middle East, Latin America, where they seek to develop cooperative ties of various sorts. They also refrain from selling to politically hostile (East bloc) or overly embarrassing (South Africa at times of great black African objection) regimes. See Jean Klein, "France and the Arms Trade," in The Gun Merchants : Politics and Policies of the Major Arms Suppliers, ed. by Cindy Cannizzo (New York: Pergamon Press, 1980), pp.127-66.

21. See the statement by Lord Newall, Hansards, House of Lords, op.cit. The impact of the Falklands dispute of 1982 may be to reinforce the arguments of those, often not taken seriously in recent years, who maintain that Britain could still become involved, on her own, in foreign wars and has lingering foreign responsibilities to shoulder. Unfortunately the Falklands also calls into question the wisdom of a free and easy arms export policy, as the Canberras, Sea Darts, Sea Wolfs, overage destroyers and carrier, and Lynx helicopters in the British-trained Argentinian fleet came back to haunt British seamen in the South Atlantic.

22. The U.K. has favored and proposed, in multilateral arms control meetings,

22. (cont.)

regional restraints on arms transfers, based on supplier-recipient agreements. London also co-sponsored the draft U.N. convention on the transfer of inhumane weapons -- such as certain mines, boobytraps, incendiary, and plastic fragmentation devices. While all weapons could be classed as inhumane, evidently Britain saw these in particular as a threat in the hands of groups like the I.R.A. Britain also supported the U.N. study of conventional arms trade, approved in principle in 1980, and advocated the publication by all states of total volumes of arms production and trade (it was thought best to have Denmark and non-aligned Singapore introduce the actual proposal). London is concerned that the USSR comply with provisions of full disclosure in any world arms register, although the proposal for only aggregate production and trade figures fits Britain's own tradition of secrecy about recipients of arms and details of individual deals. See Hurd's testimony, op.cit., pp.41-42.

23. Hurd, op.cit., p.51.

24. Ibid., p.48; see also, Lawrence G. Franko, "Restraining Arms Exports to the Third World : Will Europe Agree?" Survival (Jan/Feb. 1979), pp.14-25.

25. Personal confidential interview, December 1981.

26. Sir Ronald Ellis, "The Future of British Defence Sales," Defence Attaché (November-December 1979), p.17.

27. Debate on "Defence Equipment," Lords, op.cit.

28. Guardian (June 9, 1980). As Lord Strathcona put it in March 1980: "We would not sell arms to what we would regard as repressive regimes." The April modification read, "Under some definitions there are practically no countries in the world which do not resort to what some people would regard as torture."

29. DSO officials sit on the Defence Equipment Policy Committee, which affords impact on design specifications, as well as on the Operational Requirements Committee which initially approves services' priorities. DSO has constant access and liaison with the three services, and on the National Defence Coordinating Council, which brings together top level ministry and management people to discuss long term sales and contracting issues, such as types of contracts, role of subcontractors, and organization of government sales missions abroad.

30. James Bellini and Geoffrey Pattie, A New World Role for the Medium Power: The British Opportunity (London: Royal United Services Institute, 1977).

31. The fact that government control is increasingly seen as a matter of financial arrangements rather than administrative edicts is seen in the controversy about what type of contract to award. Fixed-price contracts insure against cost-overruns, while cost-plus (or minus) contracts allow for inflation and unforeseen costs. The trend has been toward fixed-price, and yet the government in recent naval missile contracts has opted for variable cost contracts, much to the displeasure of some parliamentarians. The reason purportedly is a concern that companies not make excessive profits by cutting costs in fixed-price deals and thereby pocket the difference. Supposedly variable cost contracts pay less if production costs are reduced. Why a company would have incentives to reduce costs if government payments go down accordingly is not clear. See reports by defense correspondent, Bridget Bloom, Financial Times, (January 21, 1982 and seriatim 1982).

32. The Public Accounts Committee estimated in 1977 that only 10% of ROF exports were at a real profit, with over half at an effective and considerable loss.

33. The fund must cover the cost of all goods and services received and charge for all supplies of goods and services to the government (in fact ROF's and other manufacturers have improved productivity and charged for deliveries faster than the government was able to pay from the votes during 1981-82, thus compounding the defense budget crisis). The ROF's also have a profound impact on the private sector, since nearly 80% of their support work is subcontracted to U.K. firms. In fact the loss of Iranian tank orders affected the private subcontractors more than ROF's, since only 10% of ROF production was taken up in the project.

The trading fund system was set up in 1974, with initial assets of £35m public dividend capital and £59.5m in debt to the National Loan Fund (NLF). Indebtedness to the NLF cannot exceed the original debt by more than £50m on principal, and the fund must be managed so revenue is sufficient to meet costs, cover depreciation (replacement), and pay an average dividend of 10% per year over five year periods. The ROF's have managed to meet these terms. The growth of ROF overseas sales and Iran's impact are seen below:

Sales	78-79	77-78	76-77	75-76	74-5 (9 Mos)
U.K.	132.9 (47%)	123.3 (47%)	102.3 (48%)	79.3 (53%)	44.1 (54%)
Overseas	151.2 (53%)	139.8 (53%)	108.7 (52%)	69.9 (47%)	37.9 (46%)
Total	284	263	211	149	82
Surpluses After Deprec.	31.2	38.6	34.3	13.9	4.1
% surplus to sales	11	15	16	9	5

33. (cont.)

Yearly Dividends from the trading fund are negotiated with the Treasury once trade results are known. The repayment to the NLF is also determined as is the amount ROF's can keep in reserves - an amount evidently raised in the aftermath of Iran as ROF's trade with unstable regimes.
See Government Trading Funds Act 1973, Royal Ordnance Factories Trading Fund Accounts, 1978-79 (London: Her Majesty's Stationers Office, December 1979); House of Commons, Public Accounts Committee, Hearings 1980-81 Session, p.23; U.K. Ministry of Defence, Defence in the 1980's (Statement on the Defence Estimates), vol. 1 (1980), pp.29 and 82; House of Commons, Public Accounts Committee, Hearings, Sixteenth Report, 1979-80 Session.

34. The ROF Director has indicated that this arrangement was somewhat inequitable, but that new arrangements had been devised in 1978 to lessen the need for extra payment to MOD evidently by providing more initially; indeed he would have to be convinced to make such payments in future. Under arrangements being discussed, more risk for bad debts would be borne directly by ROF's or jointly with IMS-ROF and customer. This is important since approximately £87m in bad debts on arms exports went uncollected by MOD, according to the Parliamentary Public Accounts Committee in 1976-77 alone. Public Accounts Committee, Sixteenth Report, op.cit., pp.22-23. Poor bookkeeping and collection seems an endemic problem in defense sales for a variety of countries. In Britain, according to 1978 reports in the Guardian, invoices to customers for payment on training and ammunition sales frequently were not even presented until long after MOD votes had been used to pay contractors. The MOD promised computerized invoice control for 1979.

35. In ROF's case, labor unrest has added to government financial worries in the past, since employees are civil servants and must be paid out of government accounts and pension schemes. Difficulties in Iran and poor trading conditions abroad reportedly added to these concerns, despite the facts that ROF's have paid £40m in dividends in the past 6 years and reinvested £100m. Financial Times (May 15, 1981 and September 26, 1980).

36. In fact, since nationalization in 1977, BS has obtained export orders for four support and 30 patrol craft, only to have the number of support vessels later cut to two. Fourteen of the patrol craft were to be built overseas under license. House of Commons Debates, Hansard's (January 29, 1981; and The Observer (January 11, 1981).

37. Public Accounts Committee, Hearings, 80-81, op.cit., p.28.

38. See testimony by Sir John Cuckney, Director of IMS, Public Accounts

38. (cont.)

Committee, Hearings, 80-81, op.cit., p.86;and Public Accounts Committee, Hearings, 80-81 op.cit., Appendix IX.

39. J. W. Sutherland, "Export Selling of Defence Electronics," presentation to Conference on Arms Sales and Political Influence, University of Southampton, April 1972.

40. Personal confidential interview (March 1982). One electronics firm purportedly earmarks a set 5% of turnover for private (risk) ventures, relying on government subsidies and contracts for the rest.

41. Personal confidential interview, March 1982.

42. Ratings are arranged in four categories; oil rich LDC's are relatively high, but Libya for example has a poor payment record (ECGD once had to cover a deficit) and, along with Oman (despite close British connections) and Iraq are on the lower "C" rather than "B" list. Oddly enough, Egypt ranks higher. Most NATO countries and EEC members, including Greece, are rated as "A" level risks along with South Africa and Namibia; Turkey however is lower. South African "homelands" are on the "D" or lowest list. Zambia and Iran have been considered such poor repayers that they are off the list and entirely restricted. All categories of countries can get short term (6 month) credit, but the "D" or lowest category is excluded from longer term commitments. In more controversial "national interest" arms sales, including all sales of lethal equipment or with large monetary value, Whitehall is consulted as well before issuing the guarantees.

43. The terms of the loans are generally shorter in arms than in civil sales, normally 5-8 years at not lower than the OECD limit of 8½%; recently rates have ranged between 10 and 11%, depending on the country's credit rating, because of the tight money situation. In collaborative production (with other countries), the exporter obtains the percentage of credit from each country's government equal to that country's share of production. Sterling is generally used for ECGD cover and loans, but dollars are used by the U.K. in collaborative sales to provide credit and avoid mixes of currencies in such multiple stream financing. Debtors sometimes prefer to obtain multiple currencies and thereby pay lower returns through speculative balancing.

44. Personal confidential interview, January 1982.