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**THE SOUTH AFRICAN MILITARY AEROSPACE INDUSTRY:
AN OVERVIEW OF THE SPECIAL DEFENCE ACCOUNT
MORE COMMONLY KNOWN AS
“THE SOUTH AFRICAN ARMS DEAL”**



A minithesis submitted in partial fulfilment of the requirements for the degree of Legum Magister in the Department of Law of, University of the Western Cape.

Supervisor: Mr John Hunt

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ABSTRACT

In this minithesis I will attempt to show international trade in practice by critically examining the highly controversial Special Defence Account, more commonly known as the South African arms deal. The paper focuses specifically on the South African Military Aerospace Industry as most of the weapons procured under the arms deal were military aircraft. Taking into account the numerous social needs of South Africa, the purpose of this paper is to, *inter alia*, try to establish the rationale behind the South African government's decision to purchase an array of military weapons from foreign suppliers at an initial cost of almost thirty billion rand. In order to gain a better understanding of the topic I will firstly give a brief overview and history of the South African Aerospace Industry. I furthermore examine the politics of the transition from apartheid to democracy and how this affected the aerospace industry

The second part of the paper examines how the idea of the Special Defence Account was conceived and examines the procurement policy and procedures employed by the government in the finalisation of their purchase agreements. One of the most important aspects of the arms deal was the financing thereof, this paper accordingly examines method in which the government financed the acquisition of the weapons and armaments. To this end I discuss the complex financing structure and look at the role of international financiers and credit agencies. The arms deal has been defended on the grounds of the offsets which accompanied it and was a major factor in winning support for it within the South African government to proceed with the deal. The paper examines the whole concept of industrial participation and how it applied to the arms deal. In this regard I argue that offsets arrangements are nothing more than a marketing ploy by arms companies and are of no or little economic benefit.

The arms deal has been synonymous with allegations of corruption and to this end we look at the effects of corruption as they apply to arms transfers. I argue that government erred in their decision to embark on an arms procurement exercise so early in South Africa's democracy and argue that there are far more important social issues which needed to be addressed. I attempt to show that the South African bowed to pressure by arms suppliers and their governments and, in so doing procured equipment which is inappropriate and too expensive.



DECLARATION

I declare that *The South African Military Aerospace Industry: An overview of the Special Defence Account more commonly known as the South African Arms Deal* is my own work, that it has not been submitted before any degree or examination in any other university, and that all the sources I have used or quoted have been indicated and acknowledged as complete references.

Kurt Ryan Collison

November 2007

Signed:.....



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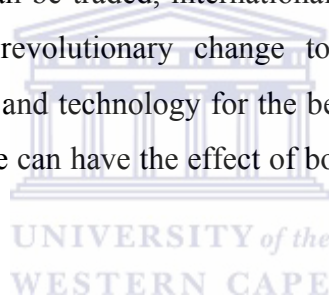
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Introduction

International trade involves the flow of goods and services across national frontiers and it can be seen as the very heartbeat of the world economy. International trade has undoubtedly evolved, from what was perceived as an exclusive domain, accessible only to a limited and exclusive elite, to a much more open and free market. Globalisation has in the past twenty years changed the face of international trade enabling more and more companies and industries to access previously untapped world markets. There are many benefits to international trade and the World Trade Organisation (WTO) promotes itself as a mechanism to attain these benefits. Indeed, the WTO claims that by subscribing to its “trading system” it is able to achieve benefits such as the promotion of peace, freer trade and the promotion of good governance to name but a few¹. In reality there are very few limitations to the types of goods and services that can be traded, international trade can therefore be used as a vehicle to bring about revolutionary change to countries and communities by introducing new products and technology for the benefit of end users. Utilised in this manner, international trade can have the effect of bolstering economies and improving quality of life in general.



However, not all goods and services traded has the resultant effect of improving the quality of life for the end user. The international trade of weapons and armaments has become a booming industry, literally worth billions of US dollars, British Pounds and Euros annually. Anything from bullets, bombs and tanks to laser guided missiles and supersonic fighter jets can be bought and traded on the open market at the right price. There are regular arms trade fairs where manufactures exhibit their goods and show their effectiveness on the battle fields, they even offer prospective buyers specials and discounts just as you would find in your local grocery store. It goes without saying that international trade in weapons and arms is a highly lucrative and profitable industry, but contrary to other forms of trade in goods and services where both sides to the transaction can benefit, there appears to be only one party who derives benefit from this form of trade, the manufacturers and suppliers. International trade has been an effective vehicle which has contributed to the prolific growth in the arms industry. Amazingly, this form of trade has gone relatively unnoticed and to some degree unchecked for years.

One of the reasons for this is that the transactions are conducted *inter* governments and huge corporations with most of the negotiations and number crunching being done behind closed doors and, preferably so as the purchasing governments utilise tax payers monies to acquire their military hardware.

South Africa, being a relatively newborn to the world economy has already become an active participant in this sector of international trade. The South African budget for the financial year 2003/4 was an amount of R20, 05 billion. Of this total an amount of R8, 844 billion was allocated to a Special Defence Account, much the greater part of which was devoted to a package of arms purchases from the UK and other European countries. When the package was negotiated in 1999 it was priced at R30 billion, but by 2003 the estimated cost had risen to R52 billion, spread over 14 years.

The deal initially comprised of the following items:

- 28 Gripen fighter aircraft to be acquired from the Anglo-Swedish company SAAB for an amount of R11,2 billion;
- 24 Hawk lead-in trainers (fighter jets) to be acquired from British company BAe Systems for an amount of R4,728 billion;
- 4 Super Lynx helicopters to be acquired from the British company GKN Westland for an amount of R787 million;
- 40 utility helicopters from the Italian company Augusta for an amount of R2 168 billion; and
- The balance of the allocated Special Defence Account was to be utilised to acquire 4 frigates and 3 submarines from a German shipbuilding consortia.⁻²

This paper attempts to critically examine the much publicised and highly controversial procurement and arms deal entered into between South Africa (as purchaser) and several European Countries (as sellers). In particular, the paper looks at the South Africa military aerospace industry, primarily due to the fact that the biggest portion of the arms deal budget was allocated for the acquisition of state of the art military aircraft. In doing so, certain fundamental questions, *inter alia*, are posed and addressed:

Is there a real and or perceived threat against South Africa or its interests to justify such a drastic rearmament campaign, and if so what exactly are these immanent dangers/threats? Was it really necessary for South Africa to acquire of such expensive military hardware when there are clearly other issues in the country such as housing, HIV/Aids and rising unemployment to name but a few which requires immediate attention? What was the rationale of this young government to embark on such a huge militarization procurement campaign given the countries turbulent history and struggling economy? (at the time of the acquisition) What were the true costs involved in this exercise and how exactly were the transactions financed? These are by no means an exhaustive list of questions which are tackled and many more issues and questions are raised and addressed throughout the paper.

It will no doubt be prudent to firstly look at the history of the South African military aerospace industry; what are their current functions and capabilities and what exactly were the factors which influenced the need to acquire the new aircraft. It is clear from research that the concept of the South African arms deal was not conceived four or five years ago but more than ten years ago, ironically together with the ushering in of a new democratic dispensation. To gain a better understanding of the rationale behind the acquisition it would be wise, at the outset to also to briefly examine the politics of the transition from apartheid to democracy. In addition to examining the procedures involved in the procurement of the arms, this paper will attempt to see exactly how this deal was financed and at what cost. The financing of the deal is paramount as research shows that the common denominator in aspects of the deal is money, the lack thereof, the abundance thereof and the misappropriation thereof. The paper will look at the complex financing structures and the role of international financiers such as Barclays International PLC, Commerzbank and the Export Credit Guarantee Department of the United Kingdom.

The paper furthermore attempts to take a closer look at the key role players involved in the arms deal, in particular the relationship between the governments and merchants of the supplying countries and how they work closely together to secure their interests. It can be said at the outset that the conception and subsequent decision to proceed with the purchases of new military equipment was essentially a political one.

It is therefore important to also understand the thinking and functioning of the purchasing government together with their agencies in regard to their procurement policies and how they went about enforcing and defending their decision to proceed with the arms deal. It is abundantly clear from research material that almost every major international arms deal post world war two has been shrouded in a cloak of controversy and allegations of corruption and, the South African deal was no different. The fact that there was a strong opposition against the acquisition naturally led to suspicion of corrupt inducements which subsequently led to the arrest and successful prosecution of some prominent figures involved in the arms deal and, as is common knowledge investigations are currently still underway against a senior politician and a international company for their alleged corrupt involvement in the deal. The paper therefore also deals with the issue of corruption and no research paper dealing with the arms deal can be complete without commentary relating to the aspect of corruption. The paper also explores some of the reasons why many arms deals are and, will probably always be synonymous with corruption.

Those supporting the arms deal have essentially defended the programme on the grounds of the offset programme which accompanied it and, it appears that this programme was certainly a major factor in winning support within the South African government. The offset programme or Industrial participation as it is more commonly known is a programme that seeks to leverage benefits and support the development of a country's industry by effectively utilizing the instrument of government procurement.³ In other words and in the case of the arms deal, in return for the purchase of military hardware, the suppliers would be obliged to invest in the South African economy. Notwithstanding the fact that offsets are generally contrary to international law as they constitute effective barriers to trade, the real question is whether these counter investments are actually economically viable and sustainable. Superficially it appears to be a good deal but the programme has in recent times come under heavy criticism in that it is claimed to be neither sustainable nor economically viable as well as the fact that there appears to be a lack of control and enforcement on the side of the South African government with regard to the fulfilment of the obligations of the suppliers.

The paper therefore critically examines the whole concept of Industrial Participation and the obligations arising from the programme in order to establish if South Africa really did or, will benefit from these counter-trades or was it simply an effective marketing gimmick to lure the government into financially onerous contracts.

The Paper finally looks as at the current state of the of the South African aerospace industry and some current developments therein, in particular the South African governments partnership with the aeronautical company Airbus and other countries to build and acquire a new military transporter, the Airbus A400M. In view of the aftermath of the arms deal, the question is asked whether this proposed international joint venture is not merely tantamount to another arms deal saga. With a price tag of one billion rand each, the South African government has made provision for the acquisition of eight of these aircraft with the first delivery expected in 2010. It certainly appears that the South African government has taken a robust approach toward its aerospace industry and appears to be committed to its growth and expansion. The paper also looks at the proposed benefits which are supposed to be derived from acquisition of the A400M, the economics involved as well as the relationship between participating countries and governments and, most importantly highlights the importance and practical functioning of international trade and finance in this sector.

Chapter 1

History of the military aerospace and arms industries

History of the military aerospace and arms industries

The South African military aerospace industry and air force has its history of inception as far back as World War One.⁴ The South African Air Force (SAAF), which is today widely regarded as Africa's most sophisticated air force and is the second oldest air force in the commonwealth, was by no means the nation's first airborne fighting force. That honour belongs to the South African Aviation Corps (SAAC), a citizen force unit set up in Britain during World War One and dispatched to German South West Africa in 1915. When that campaign ended the unit was disbanded although some of its personnel went on to serve with other Royal Flying Corps Squadrons for the remainder of World War One.⁵

In 1915 the Union of South Africa received a donation of one hundred surplus warplanes, spares and support equipment from Great Britain, a move which paved the way for the formation and founding of the SAAF on the 01 February 1920.⁶ Approximately one year later the first Air force base was established on the outskirts of Pretoria known as Air Force Base Swartkop. The SAAF first mobilised in 1922 against striking Rand Gold mining workers. General Jan Smuts had declared martial law in response to violent labour dispute clashes and ordered a bombing squadron from Air Force Base Swartkop to fly reconnaissance and bombing sorties over striker's positions.⁷ The SAAF claimed its first blood in the skirmishes but also suffered its first losses when miners managed to shoot down two aircraft killing two crew members and injuring two others. Later that year and in 1925, the SAAF was dispatched to help suppress ethnic rebellions in the then German South West Africa (Namibia).⁸

The Great Depression took its toll on the SAAF and with drastic budget cuts, development and growth in the SAAF came to a virtual standstill. Notwithstanding, the SAAF managed to secure sufficient funds to refurbish its aircraft and artillery depots which paved the way for the first licensed production of a foreign Aircraft known as the Wapiti.

The Wapiti became the first of a line of foreign types which were manufactured or assembled locally under license and heralded the beginning of an indigenous aerospace industry.

Following economic recovery in the mid-1930's, the government approved a SAAF training scheme for one thousand student pilots and one thousand seven hundred mechanics. The air force also expanded to seven squadrons with new bases opening in Bloemfontein, Durban and Cape Town.⁻⁹

Despite its growth, the SAAF was relatively unprepared for the large scale operation which Second World War demanded. This factor led to the formation of the Joint Air Training Scheme which was a programme to train, as expediently as effectively as possible Royal Air Force, SAAF and other allied air and ground crews at 38 South African-based air schools. The SAAF was then capable to mobilise effectively and subsequently played a significant role on the battlefields of North and East Africa, the Mediterranean, the Balkans and in Italy. In Poland the SAAF provided vital support to the Polish Resistance during the "Warsaw Concerto" campaign. Besides its combat role, the SAAF, as part of the Allied Joint Air Training Scheme, produced more than 33 000 aircrew and provided invaluable maritime cover along the sub-continent's coast line, keeping the strategic shipping lane clear of enemy warships and submarines. At the height of the war in 1944, the SAAF comprised 35 operational squadrons operating 33 different aircraft types including the Douglas C-47 Dakota's, Douglas Bostons, Vickers Wellingtons, Spitfires, Kittyhawks and Havilland Mosquitoes.⁻¹⁰ The SAAF also contributed toward the United Nations peacekeeping mission in Korea by the deployment of a squadron known as the "Flying Cheetahs". The squadron first flew F-51D Mustangs before moving on to the North American F-86F Sabre jets and distinguished itself in battle with several pilots receiving commendations and other decorations.

In the 1960's and 70s the SAAF expanded its response to the regional threat against South Africa posed by its Warsaw bloc-backed neighbours. This ushered in a period of modernisation for the SAAF and the Atlas Aircraft Corporation was established on the 8 October 1966 to produce, under licence an advanced jet trainer known as the Impala Mk.⁻¹¹

This period of modernisation and the response to the then regional threat by its neighbours resulted in the acquisition of other new fighter jets, bombers, transporters and helicopters and the development of locally manufactured air-launched ordnance. The biggest expansion occurred during the 1960s with the arrival of a fleet of Mirage III fighter jets, English Electric Canberras, Buccaneer bombers, and Hercules transporters.

Other additions were the Alouette II, III, Puma, Super Frelon and Westland Wasp Helicopters. South Africa still administered Namibia (then South West Africa) in terms of a mandate received after World War One. Dissent and dissatisfaction with the South African rule was growing and an organisation known as the South West African Peoples Organisation (SWAPO) was formed as a vehicle to gain independence and liberation from South Africa. SWAPO became increasingly militant from 1959 and its military wing, Peoples Liberation Army of Namibia (PLAN) was formed in 1962 and was primarily based in Zambia. The first incursions by South Africa into Namibia occurred in September 1965 and March 1966 respectively and the first major clash between a unit of the South African Police assisted by the SAAF helicopters and SWAPO occurred on the 26 August 1966 – it was this incident which heralded the start of the twenty three year long war known as the “Border War”.⁻¹²

In 1966 an organisation known as The National Union for the Total Independence of Angola (UNITA) took up arms against Portuguese rule in Angola. South Africa decided to assist the Portuguese and sent in SAAF helicopters to support their troops. However the Portuguese were unable to maintain control of Angola and independence was achieved on the 11 November 1975. Just prior to Angola’s independence though, Cuban forces started to move into Angola and South Africa faced the possibility of having a communist state bordering Namibia. Ironically South Africa, with the assistance of The Central Intelligence Agency of the United States (CIA) began to assist UNITA. The SAAF and SADF entered Angola during an operation known as “Operation Savannah” using helicopters, light aircraft and transporter aircraft. The South Africans strategically positioned itself within artillery range of Luanda, but were forced to retreat when covert CIA support was withdrawn. SAAF fighter jet and bomber squadrons consisting of English Electric Canberras, Buccaneer bombers and Mirage and Impala Fighter jets first saw action in 1978 at Cassinga in Angola.⁻¹³

From the late 1970's the SAAF participated in almost all military operations across South Africa borders into Angola, Zambia, Zimbabwe, Botswana and Mozambique. South Africa also became involved in the conflict between UNITA and The Movement for the Liberation of Angola (MPLA), the latter organisation being backed by Cuba and the Soviet Union. The United Nations arms embargo against South Africa prevented the SAAF from acquiring more modern aircraft which could match the superiority of the Russian MiG fighter jets.⁻¹⁴ The trade and arms embargo against South Africa, between the mid-1970s and 1994 did however force the country to become logistically self-sufficient.

With the government of the day allocating large amounts of public money toward its defence budget, the armaments and defence industry experienced immense growth and development. It therefore did not take long for the industry to become adept at customising existing technology to suit local operational conditions. During the eighties much attention was given to new aircraft development projects. It was during this era that the local armaments industry developed the Cheetah Fighter Aircraft as well as the Rooivalk combat support helicopters. The SAAF's new supersonic fighter aircraft, the Cheetah, was unveiled at the Atlas Aircraft Corporation on the 16 July 1986. Simultaneously, South Africa entered into the realms of "smart weaponry" with the development of laser-guided bombs and air-launched stand-off missiles and had a significant impact in the final years of the war on the Namibian/Angola.⁻¹⁵

Until the mid seventies the apartheid regime had maintained a tight grip on matters within its borders mainly by the use of civilian police and intelligence services. The government however viewed the ushering in of pro-communist regimes in Angola and Mozambique as a serious external military threat. P.W. Botha took over the reigns of president of the country in 1978 and had strong links with the armed forces rather with the security force. Botha made no excuses about showing his support of the armed forces and their increasing involvement in matters of domestic security issues, traditionally administered by the security forces. More public funds were allocated toward the expansion and further development of the armed forces and from then on military expenditure rapidly increased.

This era saw the establishment and incorporation of a state entity that was responsible for equipping the armed forces with modern weapons, known as the Armaments Corporation of South Africa (Armcor). Due to its policy of apartheid and as a part of a campaign to exert pressure on the oppressive South African regime, the United Nations promulgated an arms embargo against South Africa in 1964 which was made mandatory in 1977.

This of course made it extremely difficult for Armcor to fulfil its mandate as the technology for its weapons were derived from international sources. Some countries however chose to ignore the embargo and continued to trade in arms and weapons technology with South Africa. France supplied South Africa with the Mirage Fighter aircraft as well as Daphne class submarines. Israel continued to support South African rocket scientists to develop sophisticated missiles and subsequently provided the necessary assistance to engineers for the development of the Cheetah fighter aircraft (which essentially was an upgrade of the Mirage fighter aircraft).⁻¹⁶ More significantly, the Israelis assisted South African scientists to develop and even test nuclear weapons. It was also reported that United States provided some military assistance to South Africa during the embargo.⁻¹⁷ Due to the fact that South Africa, since World War Two had arms producing capabilities, there were no shortage of scientists and engineers who, with the clandestine assistance of their international counterparts had no problems in substituting imports with locally manufactured weapons and armaments. Generally, South Africa accomplished this by acquiring specimens of foreign equipment, sometimes through third parties, and then applying its skills to their improvement. In fact, the local industry boasted of being a world leader in the field of upgrading outdated systems. Examples of their work were the Cheetah fighter aircraft which, as mentioned above were upgrades of the Mirage aircraft, the Olifant tanks were basically old British Centurion tanks which South Africa bought from India, the Impala advanced jet trainers were derived from an Italian prototype jet fighter known as the Aermacchi MB-326, the Rooikat armoured vehicles were developed from the French Panhard armoured cars and the Rooivalk helicopter is in fact a derivative from the French Puma helicopter.⁻¹⁸ As a result of this recycling and renewal of technology, by the end of the apartheid era the local arms industry had managed to produce a relatively wide range of reasonable efficient weaponry.

In certain instances Armscor even produced world class hardware like mine protected armoured vehicles, including the infamous Caspers and Buffels used extensively in areas of civil unrest, as well as guided missiles and long range artillery weapons like the G7 105mm calibre howitzer and the G5 155mm calibre howitzer, which were developed through Armscor with the assistance of Canadian scientist Gerald Bull and his company, Space Research Corporation as well as some help from the Israelis.⁻¹⁹

Notwithstanding the advances made by Armscor during isolation, the arms embargo and sanctions did in fact have a limiting effect on weapons development and South Africa's war-making capabilities. As eluded to above, this became evident during South Africa's involvement in the Namibian/Angolan war when in early 1988 the then South African Defence Force (SADF) suffered a defeat at the hands of Angolan and Cuban forces in the battle of Cuito Canvale, an event which severely dented the reputation of the defence force and subsequently contributed to the unwinding of the apartheid regime. It was said that the main reason for the defeat was South Africa's inability to gain dominance and superiority in the air. Most military experts would probably agree that if a side is able to gain control over the skies, two thirds of the war is already won. The SAAF's Mirage squadrons were simply no match for Angola's Russian built MiG -21's.

It was not only in the air that the SADF failed to dominate but also on sea, the South African Navy which was once known as possessing a "blue water" fleet rapidly deteriorated to a mere three ageing submarines and a few coastal patrol vessels. In 1990 military expenditure had reached a peak of ten billion rand and between 1989 and 1994, under the presidency of F. W. de Klerk the defence budget was cut by a whopping fifty five percent. The budget cut and change in internal government priorities saw the rationalisation and re-orientation SAAF. It's fleet was scaled down, squadrons were disbanded; and numerous aircrafts types were withdrawn from service including the Mirage III's, the Mirage F1CZs, Buccaneers, the English Electric Canberras and the Impala fighter jets to name but a few. Numerous bases and depots were closed, staff retrenched and/or relocated.

The only new aircraft to enter service was the Pilatus Astra PC-7MkII trainer which is a single propeller driven aircraft that replaced the ageing fleet of Impala jet trainers which, were by now becoming unreliable and whose safety record was tarnished by a number of fatal accidents during training exercises. As a result of these budget cuts the arms industry as a whole lost more than half of its 160 000 labour force.⁻²⁰

Despite the rationalisation and budget cuts the arms industry the newly democratically elected transitional government inherited a significant economic power, contributing about 4% of manufacturing output and 1% of the Gross Domestic Product (GDP). A new state owned corporation known as Denel (Pty) Ltd was largely responsible for the bulk of arms output just prior to and during the country's transitional phase from apartheid to democracy.

The mandate and rationale for the incorporation of Denel (Pty) Ltd was to effectively take over the production function from Armscor while Armscor would primarily be responsible for procurement and exports. The Denel group structure was essentially set up so that it would operate as a holding company with a number of specialist operating subsidiaries with the most important being; Denel Aviation (formerly Atlas Aviation) which produced Rooivalk and Oryx helicopters and upgraded Mirage fighter jets as well as small artillery and arms; Kentron which produced missiles and unmanned aerial crafts and avionics; and Somchem which produced ammunition and explosive. Companies within the private sector also formed part of the overall arms industry with more than 1500 firms engaged in sub-contacting work commissioned by the Denel group.

There were however three main engineering companies the private sector that were awarded most of Denel's subcontracting work namely Altech Defence Systems, Grintek which formed part of Grinaker Electronics and Reunert's Remech and Reutech group which manufactured armoured vehicles and radio and radar equipment.

Prior to the transition from apartheid to democracy fifty arms companies, including Denel formed of a highly influential and powerful association known as the South African Defence Industries Association (SADIA), which claimed that their mission was to promote the development of an economically viable, internationally competitive defence industry in South Africa, serving the needs the soon to be restructured South African National Defence Force (SANDF), this notwithstanding the fact that the arms industry, at that stage faced an uncertain future.⁻²¹

With the ushering in of a democratically elected government many South African citizens were of the opinion that defence spending would take a “back seat” to other more pressing social needs. Indeed even within the new government, the leaders charged with the responsibility of social upliftment and development had justifiable reasons to demand a greater share of the budget pie. Even the then Minister of Housing Joe Slovo, being a former Umkhonto weSizwe (MK) commander propagated this view. As a result, in the early days of the new government militarism was kept in check by idealism, reinforced by financial constraints. However, not all in the new government shared this view; rumblings of more influential and powerful leaders within the ruling government could be heard and were soon to flex their muscles to obtain what they desired.

Chapter 2

2.1 Politics of the transition –the conception and birth of the arms deal

2.2 South African arms procurement and arms exports – a brief historical overview

2.1 Politics of the transition – the conception and birth of the arms deal

As mentioned above the decision to proceed with the arms deal was a political one and not necessitated by an immediate military threat against South Africa of any kind. It is therefore imperative to examine the politics of transition to gain a better understanding of the motivation which led to the decision to proceed with the arms deal.

As is common knowledge the process of transition from apartheid to democracy was not an easy one and was by no means an easy feat for the democratic forces, rather the process of transition was forged and characterised by lengthy and tough negotiations between members of the incumbent government and the then present government. It was an extremely volatile time in the history of South Africa with sporadic acts of violence and unrest being the order of the day. The result however was momentous for the country and indeed for the rest of the world who, had been waiting with baited breath to see whether the country would plunge into civil war or emerge victoriously after years of oppression. The key to the relatively peaceful transition can be attributed to the talks held between African National Congress (ANC) leaders being Nelson Mandela, Thabo Mbeki and Jacob Zuma on the one hand and retired General and right-wing politician Constand Viljoen on the other.²² Although the result was a sure victory for democracy it must always be remembered that it was a negotiated settlement whereby the non-white majority were granted political power in return for guarantees of essential white interests. The African National Congress (ANC) along with its allies had to accept an economic capitalist system and even more crucially had to come to terms with the South African military-industrial complex. The South African Defence force would go through a rebirth and an appropriate change of name to the South African National Defence Force (SANDF). Part of the rebirth process involved the absorption and integration of former freedom fighters and guerrillas of the former liberation movements and notwithstanding this process the organisation maintained its capacity to be a fighting force.

After 1994, the newly elected democratic government set about revisiting all aspects of national life with a view to transforming the country so as to suite the new democratic order that they wished to build. Attention was now focused on matters of social interest rather than that of militarisation. As mentioned not all in the new government preached the gospel of social transformation and social upliftment. The newly appointed minister of Defence Joe Modise was a former commander of MK and was said to be a tough military man who had a notorious record for his treatment of MK cadres in guerrilla camps.⁻²³ It was even said that that Modise was more popular with the SADF than with MK cadres, notwithstanding Modise was a very powerful and influential man amongst his peers and no matter what his former foot soldiers thought of him it was his influence with the decision makers that really mattered. It therefore did not take Modise long before he made his voice heard. Coupled with the fact that then President Nelson Mandela never really professed pacifism, but instead adopted a patriotic view including the justifiable use of force for the defence of freedom and justice, made it possible for Modise and other like-minded individuals to convince the government to review the state of the defence force and the need to have respectable military power.

Notwithstanding the difficult period it endured prior to transformation, the future of the South African Arms industry was given a life line in that the interim constitution made provision, not only for the survival of the defence force but also its enhancement as it prescribed that the country should have a “a modern, balanced, technically advanced National Defence Force”⁻²⁴ This, by implication meant the survival of the arms manufacturing industry that had grown up to sustain the military. The appointment of Modise as Minister of Defence and Ronnie Kasrils as his deputy virtually guaranteed a bright future for the arms industry as they were men who were not merely coming to terms with the military-industrial complex but enthusiastically embraced it.

Despite its turbulent past and the imposition of sanctions, South Africa still managed to emerge as the leading economic power in sub-Saharan Africa. Nelson Mandela was arguably the worlds most loved leader and South Africa was rapidly gaining international recognition for its resilience and recovery from years of oppression.

Western governments were soon eager to co-opt South Africa in encouraging it to become involved in matters on the African continent with both Britain and France lobbying the government to play an active role in peace-keeping in Southern Africa.

In 1996 the United States and European Union invited South Africa to lead a regional peacekeeping force which would they would finance but which would be staffed by Africans.²⁵ South Africa did not have a good legacy within the Southern African region and its interventions in Angola, Mozambique and even Lesotho were still fresh in the minds of the citizens of its neighbouring countries, nevertheless the government of South Africa was well aware that it could not afford instability on its northern borders as it would no doubt have an adverse economic impact within its own borders if any external instability was not kept in check.

In 1994 the Southern African Development Community (SADC), although at first a purely economic body, established an Interstate Defence and Security Committee chaired by non other than South Africa's Minister of Defence Joe Modise.²⁶ It was from hereon out that the South African government became seduced by the appeal of peace-keeping. Ironically peace keeping is done by a peace-keeping force consisting of soldiers who are trained warriors and not usually keepers of the peace, South Africa was nonetheless stressing that it should play a more meaningful role on the continent. With any peace keeping mission there will undoubtedly the need to use force and, the prospect of the beneficent use of force gave the military a justifiable reason to demand a larger share of the nation's resources. Another significant event in 1994 was the fact that decline in real military spending was briefly reversed but then continued to decline largely due to pressure from the International Monetary Fund (IMF) which was concerned with the country's rising deficit. Most of the Defence budget was being used on personnel and on internal security activities and not on the acquisition of new equipment. With procurement of new equipment continuing to decline both military and industrial leaders petitioned vigorously for a change in government policy. Their pleas to government were bolstered by the fact that many military officers were resigning, frustrated with the state of affairs and with their ageing equipment.

General Johan Meiring, the then military chief of staff, addressing a military conference in London was reported as saying that the South African government should decide what value it placed on the insurance policy provided by an adequate defence machine.

In 1997 the South African Navy celebrated its 75th anniversary and President Mandela, noticing the feeble appearance of South African naval fleet as compared with visiting foreign warships said he felt embarrassed by the state of South Africa's ageing fleet and promptly promised the navy new ships.⁻²⁷

Those in government who promoted the idea of the modernisation of the South African Arms industry were naturally delighted to hear that President Mandela had made a commitment to upgrading part of South Africa's naval fleet. It is interesting to note that President Mandela never professed pacifism as did some of his peers, notably Archbishop Desmond Tutu who was (and still is) strongly opposed to the idea of militarisation. Mandela, being one of the co-founders of MK was however always open to the patriotic argument that the new South Africa, though eschewing aggression against its neighbours, should be a respectable military power. General Siphwe Nyanda, being the first black commander of the SANDF interestingly noted that the acquisition of new aircraft for the air force and warships for the navy were in fact strategically useless but would add immensely to the prestige of the defence force and government. He was quoted as saying that it was in fact the Army that would be the main tool of power projection in the region despite the fact that it was not getting any new equipment. Notwithstanding the fact that South Africa was still coming to terms with its recent past, it would ironically be during the transitional period from apartheid to democracy that the arms deal was conceived and born.

2.2 South Africa's Arms procurement and arms exports – a brief historical overview

The end of apartheid also marked the end of sanctions and isolation, South Africa was now free to enter into the international trade market once again. In dealing with its military-industrial complex South Africa could now either purchase foreign weaponry openly or its arms industry could utilise its specialist capabilities to market and sell abroad which would have the effect of bringing much needed foreign currency into the country.

Although South Africa had specialist expertise in reinventing existing technology, production of major armaments was not really its forte. The new government took a view that it would not make sense to even attempt to manufacture small numbers of warships, warplanes or tanks when the latest models could be procured from foreign industries that enjoyed economies of scale. During the arms embargo against South Africa between 1984 and 1993, South Africa still managed to maintain a low level of arms trading with fellow-pariah states like Chile under the dictatorship of Augusto Pinochet, Argentina under the leadership of the military junta, Iraq under the dictatorship of Saddam Hussein together with non-state actors like Somali clans, Lebanese militias and Ulster Loyalist paramilitaries in Ireland. Even when the arms embargo came to an end Armscor continued to trade with less desirable international buyers as was evidenced in the uncovering of a shipment of weaponry in Yemen just after the end of the civil war.

Needless to say the new government were totally embarrassed by the whole affair and promptly set up a Commission of Enquiry, headed by Judge Edwin Cameron to investigate the matter. In his findings, Justice Cameron found that Armscor had acted under a veil of secrecy and that there was little or no accountability. Armscor however saw nothing wrong as they always operated in this manner, much like their erstwhile political masters. The Commission's recommendation of transparency and the strict control over future arms sales were swiftly adopted. In addition the government removed the final decision of the licensing of exports of arms from Armscor's mandate and handed it to a high-level committee headed by then Minister of Water Resources Kader Asmal. Asmal had a strong ideology in social upliftment and education rather than militarisation and was therefore not really the most popular person in military circles. It was from this point on that Armscor was transformed but it was decided that Armscor would not be disbanded. Notwithstanding the embarrassment of the Yemen arms fiasco, the government had in principle no objection to the export of arms, provided that the purchasers were of good repute, in fact the government set a projected export target of two billion rand a year. The new government soon realised that dealing in arms was a highly lucrative affair and, although it had slapped Armscor over the wrists, it wasted no time in prospecting for new markets. Countries like Iran, Indonesia, South Korea, Syria and Turkey were now all potential clients and Armscor even managed to secure a relatively large order from Turkey.

The government however, under international pressure from the West was forced to forgo the order on account of Turkey's treatment of its ethnic Kurds, in fact President Mandela declined the award of the Turkish Ataturk Peace Prize for this very reason.⁻²⁸ Mandela however announced that he would support the sale of arms to Indonesia provided that the arms sold were not on-sold internationally. A further motivation and justification for the deal was that Indonesia under the leadership of Suharto had been a strong supporter of the anti-apartheid movement. A prospective sale to Syria did also not materialise due to pressure from the US government who have always been highly critical of Damascus.

South Africa was struggling to reach its projected arms sales target of two billion rand annual sales and in 1997 sales peaked at R1,325 billion, dropped to R874 million in 1998 and then rose to R1,090 billion in 1999. As mentioned above South African arms manufacturers were specialists in recycled technology but to their credit had developed some valuable world class weaponry, among them being the G5 155mm howitzer and G6 artillery cannon.

These artillery weapons had world-leading fire control systems and were accurate shots over long-range and as a result South Africa managed to secure sales to a number of Gulf States as well as to India and Malaysia. The rest of South Africa's military hardware which was for sale was however not doing that well with the Swiss Army purchasing mortar fuses and the Algerian army purchasing unmanned aerial vehicles and anti-tank missiles. Light armoured vehicles, specially protected against mines were sold to India, the United Nations peace keepers and to the United States Army, although the US replaced the South African engines with US engines. South Africa was however hoping to break into the international arms trading market with a substantial deal but failed to secure the same. South Africa had managed to develop and build a highly technologically advanced combat helicopter, the Rooivalk which had been specially adapted for the conditions of war in Namibia and Angola. The only "unfortunate" thing was that the helicopter only become available after the Border War had ended. Notwithstanding, the helicopter held its own against international competitors like the US Apache Attack helicopter.

South Africa desperately needed to procure some sales of this helicopter and in 1994/5 nearly managed to sell some to Great Britain in an estimated £1 billion deal but subsequently lost out to the US Apache.⁻²⁹ Although there was no use for the helicopter locally, national pride was at stake and the SAAF felt obliged to order twelve helicopters, to get a production line going and to develop confidence for prospective foreign buyers. During 2004/2005 there was a glimmer of hope for the Rooivalk as prospective deal with Turkey was likely to be finalised. Alas, in 2006 the deal fell through and the curse of the Rooivalk continued despite the fact that it has been equipped with mostly foreign engines, armour, missiles and electronics. To date it has still to secure an export order.

As major sales continued to elude South Africa, President Mandela during a state visit to Saudi Arabia in 1997 appeared to secure a R7 billion deal, however due to a sudden drop in the oil price, and probably more importantly the displeasure of the United States, the deal was shelved. Arms sales continued to be promoted by the then deputy President Thabo Mbeki with few results. President Mahatthir of Malaysia seemed to be on the point of signing a large arms package with South Africa, including Rooivalk helicopters but as fate would have it South East Asia was hit by a financial crisis and the deal was accordingly scrapped. By 1998, when Denel was financially in the red for the second year running, the South African arms industry was clearly in crisis. Its future salvation lay not in exports, but in imports and manufacturing of components.

Chapter 3

3.1 The Strategic Defence Package - First Approaches

3.2 South Africa's Procurement policy and procedure

3.1 The Strategic Defence Package – First Approaches

The wheels for arms deal or Strategic Defence Package (SDF) as it is more formally known were already set in motion prior to transformation. The old regime realised that the Navy, due to its ageing fleet was fast losing its “blue water” fleet status and was relatively inefficient in the border war. In 1993 there were reports that South Africa was on the verge of finalising a £1 billion deal with the United Kingdom for the acquisition of as many as eight new small manoeuvrable, lightly armed warships known as corvettes.⁻³⁰ The following year, South Africa saw an opportunity to bolster its own arms industry and tried turn the proposed deal into an “arms exchange” in terms of which South Africa would sell its Rooivalk helicopters to the British in exchange for the purchase of the corvettes. The deal however never materialised and it was back to the drawing board for South Africa. In 1995 South Africa had now reduced its corvette wish list to only four and the preferred source was the state-owned Bazan shipyard in Spain. The South African public did not however take well to the proposed deal as it was seen as a waste of valuable resources which could be put to better use elsewhere and, due to the huge public outcry the deal was suspended.

The upgrade of the naval fleet to blue-water status was however not abandoned and with certain politicians who advocated arms acquisition, holding positions of power and influence, the dream of acquiring new warships slowly became a reality. In 1996 the Ministry of Defence embarked on a “Defence Review Process” (DRP) in terms of which it initiated an open consultative process to establish a consensus about the future of the SANDF. The process covered a range of issues affecting the roles, structure, size and shape of the Ministry of Defence and the SANDF. It redefined the role and tasks of the SANDF as being primarily the defence of the territory of South Africa, as opposed to the pre-emptive force projection role of the old South African Defence Force. The role of regional peacekeeping was also added. It was acknowledged that there was no immediate military threat to South Africa, but the capacity to operate certain key military capabilities could not be acquired overnight.

It was therefore proposed that the SANDF would be designed as a core force that could fulfil its missions and could also be rapidly increased should the need arise.

Many critics claimed that the Ministry turned the process into a skilful public relations exercise as it was surprisingly open for anyone to voice their opinion. What was clear however was the fact that the Ministry used the DRP to promote the idea of a “strong” South Africa which could play a vital role in bringing peace to a troubled continent. The government also used the DRP as a platform to allow senior politicians to voice their approval of a proposed acquisition. The DRP also revealed that it was clear that the ruling party had taken a policy decision to proceed with a major modernisation exercise within the SANDF. Those who voiced their objection to the proposal were effectively drowned out by the overwhelming support shown by senior political leaders. The initial process culminated in a Defence White Paper in 1996, the Defence Review Report in 1998, and a White Paper on Defence Related Industries in 1999.⁻³¹ Each of these passed through the parliament portfolio committee before final approval by Cabinet.

It was clear that Joe Modise and his allies had won a political battle as parliament had now, in principle approved the modernisation of not only the navy but the air force and army as well. It was proposed that the SANDF acquire new corvettes and submarines for its navy, light fighters and light helicopters for its air force and main battle tanks for the army. The cost of this exercise would obviously be enormous and the government proposed that 1,8% of Gross Domestic Product (GDP) would be used to pay for the acquisition of the armaments as well as their operating costs. Furthermore, the government would impose industrial participation (IP) obligations to offset the effects of such a major outflow of money. Industrial participation is basically an offset system in terms of which the successful contractors would be obliged to generate economic activity consisting of exports, investments and technology transfer, generating credits equivalent to four times the contract value in hard currency.⁻³²

Many critics argued that South Africa never had the money to pay for the acquisition of the arms which were not necessary in the first place as there was no military threat against South Africa. Modise however, true to form brushed aside his critics and stated that although there was no visible threat there was always the likelihood of unforeseen aggression in an unpredictable world and the country therefore needed to be prepared to defend its freedom against this ever potential threat. This however did not change the fact that South Africa did not have the financial capability to finance the acquisition.

Ironically at the same time that the government was approving its new procurement programme, R700 million was cut from the defence budget leaving a gaping hole of approximately R4 billion between what the DRP demanded and the amount government would provide. The government's strategy however was to co-opt the vendor governments in the procurement process as opposed to negotiating directly with the individual arms companies. This strategy would make it much easier for the government to secure favourable financial terms and support.

In the early stages of the deal it appeared that the UK would be the sole supplier, it was reported that there was a £2 billion deal on the table which involved the sale of corvettes, submarines, tanks and trainer fighter jets. At the time the UK was desperately trying to dispose of four Upholder class diesel-powered submarines which had been built in the early eighties to deal with the threat of the Soviet Union. These vessels had now become redundant in the UK and were offered at the bargain price of £200 million each to South Africa. The deal however never materialised and the vessels were eventually sold to Canada.⁻³³

The South African Army's wish list included the need to secure modern air-defence weapons and new tanks. The UK was ready to meet the first requirement and offered Shorts Starbusrt or British Aerospace rapier missiles and the second with Vickers-built tanks, either second- hand Challenger 1 models or the new Challenger 2 model. The Air Force wish list comprised the need to replace its Mirage and Cheetah aircraft with a new fighter as well as a replacement of the Impala trainer jets. British Aerospace (BAe) could however only offer the SAAF the Hawk, a versatile advanced jet trainer which could be easily converted into a combat aircraft.

They (BAe) could not however offer any fighter jets to replace the Mirage and Cheetah's as its Harriers and Tornado's were fast approaching the end of their careers and were in any event considered unsuitable for South Africa. BAe however had just taken a 35% stake in the Swedish engineering company Svenska Aeroplanaktiebolaget (SAAB) who specialised in aviation, defence, vehicle design and manufacture. The primary reason for the merger was that SAAB was well renowned for its engineering abilities but was lacking when it came to effectively marketing their products. The British were historically good marketers and it therefore made good business sense for the two companies to merge. SAAB had just completed the design of a new state-of-the-art fighter plane known as the Gripen and was about to go into production for the Swedish Air Force. There was however no prospect for foreign clients at the time. BAe, being the good marketers that they are immediately seized the opportunity and punted the Gripen to South Africa as part of the arms package.

By the end of 1997 it became clear that South Africa was not in favour of having one single supplier but rather preferred to break up the package so as to distribute its patronage. Various countries including France, Germany, Italy, Spain, Russia, Brazil, Canada and the UK were now invited to tender and were all seen as prospective suppliers. The South Africans had made it quite clear to the prospective suppliers that their decision to appoint a successful candidate would be based, *inter alia*, on the ability of suppliers to provide both the finance as well as sufficient industrial participation investments. The deal was however not solely dependant on finance and industrial participation, there was also foreign policy to consider. Commentators noted that the government's first priority was to secure long term strategic alliances with its major European trading partners, including alliances for the country's defence industry with internationally successful defence groups.⁻³⁴ In doing so South Africa, through its procurement process had to ensure that it did not offend the most important of its trading partners, the UK which remained in contention. During the tendering process President Mandela's successor Thabo Mbeki had met in London with his UK counterpart Tony Blair, who promised access for South African goods to the European Union, this would obviously put pressure South Africa to pay closer attention to the UK's bid.

Spain however was soon out of the running and despite its initial promise for large amounts of industrial participation investments claimed that it now had a problem with this concept in respect of the South Africa deal. Russia was also excluded from the running primarily due to the bad reputation it has for after sales service and its bad safety record in relation to aviation products produced in that country. Germany on the other had an immaculate after sales service record and was well renowned for its engineering capabilities and focused its attention on South Africa's naval needs and duly completed a tender to supply corvettes and submarines.

The obvious non-participant in the tender process was Europe's biggest competitor, the US. It appears that this was no mistake but rather by design. Conspiracy theorists have long argued that in the New World Order which will be governed by Europe and the United States with Europe being charged with the responsibility of managing the African continent. There were also historic impediments to a close relationship between the US and South Africa. US policy toward the apartheid regime had been highly ambivalent.

Liberal opinion as well as the African-American lobby had pushed the relationship towards hostility but geopolitics, the fear of Communist take-over of a mineral-rich country at the junction of the Indian and Atlantic oceans, had made it in practice a supporter of the old regime. The new democratic regime had in no means despised the ideology of communism; in fact some of its prominent leaders were communists, this did not sit well with Washington. Nelson Mandela was well known for his stance not to bow to the demands of the US and maintained a friendly relationship with pariah states like Iran and Libya, which had helped in the liberation struggle. In 1997 South Africa was close to finalising an arms sale with Syria in terms of which Syria would acquire highly sensitive equipment. The Americans therefore had some reason to fear that arms sold to South Africa might end up in undesirable hands. The US did however make a half-hearted attempt and offered second-hand F-16 fighter jets, this offer was however a superficial one and was soon rejected. In any case, it is highly unlikely that the US would have been a preferred bidder should they have decided to seriously enter the race, because as much as they were suspicious of South Africa, the ANC lead government had not forgotten the assistance the US government provided to the apartheid era.

Joe Modise was quoted as saying that should the US have entered the race and ended up as the preferred supplier, the US would no doubt gain leverage over the country's foreign policy. This was ironic as will later be seen as the eventual successful vendor governments, in terms of their financial agreements with South Africa could possibly gain effective control over South Africa's foreign and domestic policy should South Africa default on its loan obligations.

3.2 South Africa's procurement policy and procedure

Prior to 1994, Armscor was the sole procurement authority in the Ministry of Defence. Procedures were set up to handle procurement mainly from the local industry, where usually only a limited amount of firms had the specific skills and capabilities to deliver. By the time the Strategic Defence Package (SDP) was initiated, a Defence Secretariat had been set up with specific responsibilities in the procurement process. Procurement policy had been redefined by the Defence Review Process (DRP) and it was at this point that tenders were opened with international participation encouraged. Substantial and robust procedures had been put in place to manage large projects like the SDP, ensuring the participation of the various arms of the defence force requiring the equipment. The process therefore involved the SANDF headquarters, the Secretariat of Defence, Armscor, the Minister and Deputy Minister of Defence, and Cabinet.

Various bodies were established to handle every aspect of the project from the requirement definition, project study, formal requests for information and short listing, to evaluation and finally approval of the choice of equipment. As has already been mentioned the SDP required substantial industrial participation investments as well as financing. It was therefore decided that the Departments of Trade and Industry and Finance would be involved in the evaluation process as well.

3.2.1 The Strategic Defence Packages – Joint Report

The Strategic Defence Packages Joint Report set out, *inter alia*, and in detail government procedures involved in the procurement of the arms. The following is a brief synopsis of the procurement procedures involved in the acquisition of the military aircraft: ⁻³⁵

During the early nineties the SAAF had a 3-tier fighter training philosophy. The three tiers consisted of:

- the Pilatus trainer;
- the Impala fighter trainer; and
- the Cheetah and Mirage fighters.⁻³⁶

The SAAF felt that it needed to change its philosophy and proposed a revised strategy that involved a medium fighter (as an introductory aircraft) and an advanced fighter trainer (AFT). The SAAF then embarked on a fighter programme aimed at realising its new strategy. The programme consisted of two projects known as Project Ukhozi and Project Kambro, respectively.⁻³⁷ Project Ukhozi was established to satisfy the trainer requirements (AFT) of the SAAF and focused primarily on the replacement of the 94 Impala jet trainer aircraft with 48 new trainer aircraft. According to the SAAF staff requirement the AFT aircraft had to have the capacity to carry out successfully a wide spectrum of jet conversions, advanced fighter training and combat missions. Project Kambro on the other hand was established to satisfy the medium fighter requirement, and it focused on the replacement of the Mirage and Cheetah aircraft with a multi-role supersonic fighter by the year 2012, which was described as a Future Medium Fighter (FMF).

A formal Request for Information was forwarded to 30 potential suppliers from which 23 aircraft proposals and four service proposals were received. Among the contenders who responded were Lockheed Martin, offering second-hand F-16 fighters, SAAB offering the Gripen, British Aerospace offering the Hawk and Dassault offering the Alphajet and latest version of the Mirage. The responses were duly evaluated in accordance with a proposed value system. Values were allocated to the following aspects: airframe performance, onboard systems; avionics systems; supportability systems; acquisition cost index and operating /support cost index. After the proposed value system results were presented an additional five criteria, namely: the aircraft had to be jet propelled (as opposed to propeller propulsion) and have a tandem cockpit to resemble a modern fighter, the aircraft must have shown better performance than the SAAF's existing fleet of aircraft, the aircraft must have been at an advanced stage of development or production, delivery must have been possible by 2003 and the manufacturer must have indicated a willingness to participate in the tender process by responding to requests for additional information on the aircraft that they were offering.

The project committees evaluating the tender process drew up a short list of suppliers and during September and October of 1996 visited each of the short-listed suppliers with the aim of compiling an interim project study report. The objective of the report was to recommend a further shortlist of aircraft types that would satisfy the requirements of the SAAF. The shortlist had now been reduced to nine contenders and these contenders were now further evaluated against a value system which included the following: Operational value, Logistical value and Supplier value. A cost analysis, risk analysis and a trade-off analysis were also conducted.

During January 1997, the British Government tabled a package proposal for the supply of armaments to South Africa.⁻³⁸ This included, *inter alia*, the replacement of the Impala with the Hawk jet trainer or a combination of the hawk and the Gripen fighter via British Aerospace. In response, the evaluating committee felt that the British proposal did not comply with the defined operational and logistical requirements of either the fighter or fighter trainer replacement programmes and that neither the Hawk nor Gripen systems, as offered by BAe during its formal response to the Project Ukhozi acquisition satisfied the full requirement specifications. In addition it was felt that the British proposal was too expensive and that a more cost effective package which could satisfy all the required criteria and could be obtained elsewhere. The British proposal was accordingly not accepted.

Due to budgets cuts in 1997, the acquisition process of Project Ukhozi could not continue within the proposed timescales.

The SAAF Command and Operations Council considered the budgetary implications of both Projects Ukhozi and Kambro and concluded that the projects, with severely curtailed budgets, be declared unaffordable. After some re-strategising, the SAAF Command Council came to a conclusion that a mid-range light fighter could satisfy both the projects' requirements at a lower cost. The SAAF Command and Operations Council therefore decided that Project Ukhozi had to redefine its staff requirement to that of an Advanced Light Fighter Aircraft (ALFA) concept that would meet the requirements of both Project Ukhozi and Project Kambro. This effectively meant a change from a 3-tier to a 2-tier fighter strategy. The new two tier fighter strategy would include the Pilatus Astra trainer which as mentioned is a single engine, two seated propeller driven aircraft that would be used for basic fighter orientation training.

This would be followed by jet conversion, operational conversion and operations to the Advanced Light Fighter Aircraft. The ALFA would therefore take the operations role of the Impala, Mirage and the Cheetah as the only front line fighter with precision air defence and ground attack capabilities. The SAAF was therefore essentially forced to redesign in terms of costs and not according to its requirements.

Notwithstanding the budget cuts the Ministry of Defence decided to press on with the Strategic Defence Package and reluctantly adopted the proposal of the SAAF Command and Operations Council to accept the ALFA as part of the 2-tier fighter strategy in the SDP. The adoption of the ALFA strategy effectively meant that the procurement process had to start from scratch. Accordingly, on the 23 September 1997, a Formal Request for Information for 48 aircraft were sent to the following Governments: the United Kingdom, France, Germany, Italy, Brazil, Sweden, Canada and Spain.

The respective countries responded as follows: Germany, through Daimler Benz Aerospace offered AT 2000 fighter aircraft, France through Dassault offered the Mirage 2000, Canada the CF 5, United Kingdom through BAe/SAAB the Gripen, Italy through Aermacchi the Yak/AEM 130, Russia the MiG 29 Fulcrum and the Czech Republic through Aero Vodochody offered the L159. The ALFA project team then performed an evaluation on the responses received and the results thereof were presented at a meeting of the SAAF Command Council. At the meeting of the SAAF Command Council a decision was taken to reduce the number of aircraft for the ALFA project from 48 to 38. After due consideration and, based on the results of the evaluation a shortlist of three aircraft, namely the Gripen, AT2000 and Mirage 2000 was drafted and finalised.

The next step involved forwarding a Formal Request for Information to the respective governments of the short listed aircraft. Once all relevant information was received, collated and studied, it became clear to the project committee that another type of aircraft would be required as an interim trainer which would breach the gap between the Pilatus Astra trainer (subsonic - propeller propulsion) and the ALFA (supersonic – jet propulsion). The project committee then conducted a strategic workshop to examine the possibility of the inclusion of an aircraft that was able to breach this gap. The Minister of Defence was also not in favour of the 2-tier system and accordingly rejected the proposal of ALFA as a 2-tier system.

It was then decided to revert back to a 3-tier system, incorporating both the ALFA and a lead in fighter trainer (LIFT) to breach the gap between the propeller trainer and the jet fighter. The SAAF Command Council remarked that it was essential to satisfy the requirements of the SAAF in relation to fighter training and fighter consolidation in a cost-effective manner. This marked the turning point in the SAAF strategy, which had the backing of the Minister of Defence.

As a result of this change in strategy four significant decisions were taken:

- The SAAF required both a LIFT and an ALFA, i.e. a 3-tier system.
- Both LIFT and ALFA had to be satisfied through the government-to-government SDPs.
- The LIFT constituted an additional requirement to the SDP and had to be registered as such.
- The LIFT was the more urgent requirement and had to be satisfied first.

Project Ukhozi was accordingly redefined to satisfy the requirements for the ALFA as part of a 3-tier system. A new project which involved the acquisition of 24 dual seat advanced trainer jets to satisfy the requirements of the LIFT was registered and known as Project Winchester. Project Winchester and Project Ukhozi ran parallel as a single SDP programme and all technical aspects for both projects were managed by the Ukhozi Control Council (UCC). The procurement process for the acquisition of the LIFT was based on the procurement procedures of ALFA and at the end of all requests for offers, evaluations (including cost) and formal Requests for Information. A short-list of aircraft to satisfy the LIFT was compiled which included: the Italian Aermacchi MB339FD and Yak 130, the Czech Republic's Aero Vodochody L159 and BAe's Hawk 100.

The next phase of the procurement process was a Formal Request for Offer (RFO) which was sent to the prospective suppliers. This process was managed under the auspices of a special committee known as the Strategic Offers Committee (SOFCOM).⁻³⁹ In respect of the ALFA, RFOs were issued to BAe/SAAB, Dassault and Daimler Benz Aerospace and a proposal for a visit by the UCC to these short listed contenders was also finalised. The final offers for the ALFA were received from all three contenders on 14 May 1998 and thereafter detailed evaluations of their proposals and aircraft began by specialised evaluation teams.

The total acquisition cost required for the 38 ALFA aircraft was expected to be in the order of R11 billion (1998 rand value-1US\$=R5.10) which included an initial logistic package for two years, taxes, mission equipment, mission simulator and programme management costs.

In 1997 the Department of Trade and Industry (DTI) imposed a specific policy of counter trade for all contracts in excess of US\$ 10 million. These contracts had to have a minimum of 30% National Industrial Participation (NIP) based on the contract price. Defence contracts however had to have a minimum Defence Industrial Participation (DIP) of 50%. Normal tendering procedures require a 50/50 split between DIP and NIP. A decision was however taken that if a contender committed to a 100% NIP, the contender would not be penalised. These requirements were duly communicated to the contenders and DIP and NIP evaluation teams were established to evaluate the counter trade proposals received by the contenders. The DIP evaluation team compiled a value system that was used to evaluate the bidders' offers and the final recommendation presented to SOFCOM in respect of ALFA were the following: ⁻⁴⁰

Bidder / Aircraft	Rating
Daimler Benz Aerospace – AT2000	100
BAe/SAAB – Gripen	88
Dassault – Mirage	40

and in respect of LIFT:

Bidder / Aircraft	Rating
Aermacchi – Yak 130	100
Aermacchi – MB339FD	95
BAe– Hawk	94
Aero Vodochody – L159	84

In terms of the NIP value system and evaluation, a bidder submitted its project proposals to the DTI which was evaluated by the NIP evaluation team. This team was comprised of officials from the DTI. The evaluation was performed in two parts: Part 1 was to obtain NIP credits for the value of the items, such as sales, domestic sales and investments.

This was more of a quantitative phase and involved looking at the items in the business plans and multiplying them by the weighting as per the approved value system. Part 2 was more qualitative and was made up of five sections for which points were allocated. Each section had a maximum score of 5; therefore the maximum possible score for phase two was 25. The scoring was by consensus and an objective approach was used to obtain a reasonable score. The score in part one was multiplied by the score in part two to derive at the final score. The normalised scores regarding the final NIP recommendation presented to SOFCOM in respect of the ALFA were the following: ⁻⁴¹

Bidder / Aircraft	Rating
BAe/SAAB – Gripen	100
Daimler Benz Aerospace – AT2000	11
Dassault – Mirage	7

And in respect of LIFT:

Bidder / Aircraft	Rating
BAe– Hawk	100
Aermacchi – MB339FD	25
Aermacchi – Yak 130	25
Aero Vodochody – L159	97

One of the most significant evaluations that were performed was that of finance. The contenders were obliged, as part of the procurement process to include a financial arrangement proposal. The criteria used to evaluate the finance aspect of ALFA and LIFT was twofold: critical criteria and discriminating criteria. The critical criteria used to evaluate the proposals were the following:

- Provision of a grace period in respect of the commencement of repayments up to a maximum of 4 years.
- Provision of repayment periods between 15 and 20 years, the grace period included.
- Provision of quotations for both periods i.e. 15 and 20 years respectively.
- The quotations must have included all costs.
- Currency denominations must have been expressed in US\$.

- All conversion rates used in calculations contained in the proposals had to be indicated clearly.
- All information requested had to be supplied.

The discriminating criteria in relation to the respective weighting percentages used to score the contenders were as follows:

- Cost of Finance - 30%
- Cash Flow – 30%
- Hidden cost – 30%
- Financial soundness - 10%

Once the evaluation had been completed, the scores revealed that BAe/SAAB had ranked above its competitors in that they had, *inter alia* made provision for 85% of the contract value to be financed over a period of 20 years with commitments by financiers brokered through themselves on behalf of South Africa. Dassault on the other hand only provided financing for the initial/definition phase of the contract, i.e. 0,4% of the contract value and only provided a letter of intent from a financier for the balance. The respective normalised evaluation scores/results, i.e. technical, industrial participation and finance were consolidated by SOFCOM and were presented to the Armaments Acquisition Control Board and the Armaments Acquisition Steering Board for consideration and approval. The results concerning the ALFA and LIFT were as follows:⁻⁴²

ALFA

Military value									
Offeror / Product	Programme cost (US\$m)	Finance cost (US\$)	Total cost (Net Present Value NPV @13.5%)	Military Performance Index	Military Value Index	Industrial Participation Index	Mil + IP Index	Finance Index	Best value
United Kingdom (Gripen)	2 217.0	1 252.1	3 469.1 (1067.6)	100.0	100.0	100.0	100.0	100.0	100.0
Germany (AT2000)	2 139.0	No offer	-	76.0	79.0	59.0	69.0	No offer	46.0
France (Mirage)	2 257.0	No offer	-	79.0	76.0	25.0	50.5	No offer	33.7

Industrial participation							
Country	Tender Price	DIP		NIP		Total IP	
		Value	%	Value	%	Value	%
United Kingdom	1 877.1	574.2	30.6	8 168.8	435.2	8 742.9	465.8
Germany	1 461.5	781.2	53.5	1 030.2	70.5	1 811.5	123.9
France	1 874.7	937.4	50	915.8	48.8	1 811.5	98.8

LIFT

Military value including costs									
Offeror / Product	Programme cost (US\$m)	Finance cost (US\$m)	Total cost (Net Present Value NPV @13.5%)	Military Performance Index	Military Value Index	Industrial Participation Index	Mil + IP Index	Finance Index	Best value
United Kingdom (BAe Hawk)	756.5	402.5	1159.0	90.2	45.1	100.0	89.6	100	96.5
Czech (Vodochody L59)	641.4	179.8	821.2	88.3	52.0	93.0	89.5	69.0	84.3
Italy (Aermacchi MB339FD)	377.7	139.9	517.6	100.0	100.0	62.0	100.0	92.0	100.0
Italy (Aermacchi Yak 130)	550.6	203.9	754.5	62.5	42.9	64.0	66.0	90.0	77.5

Military value excluding costs									
Offeror / Product	Programme cost (US\$m)	Finance cost (US\$m)	Total cost (Net Present Value NPV @13.5%)	Military Performance Index	Military Value Index	Industrial Participation Index	Mil + IP Index	Finance Index	Best value
United Kingdom (BAe Hawk)	756.5	402.5	1159.0	90.2	90.2	100.0	100.0	100.0	100.0
Czech (Vodochody L59)	641.4	179.8	821.2	88.3	88.3	93.0	95.3	69.0	86.3
Italy (Aermacchi)	377.7	139.9	517.6	100.0	100.0	62.0	85.2	92.0	87.5

MB339FD)									
Italy (Aermacchi Yak 130)	550.6	203.9	754.5	62.5	62.5	64.0	66.5	90.0	74.6

Industrial participation							
Country	Tender Price	DIP		NIP		Total IP	
		Value US\$	%	Value US\$	%	Value US\$	%
United Kingdom	599.0	429.4	71.7	848.5	141.7	1 277.9	213.3
Czech Republic	513.7	254.5	49.5	981.4	70.5	1 235.9	240.6
Italy- MB339FD	278.1	184.6	66.4	246.3	48.8	430.9	154.9
Italy- Yak130	420.6	237.4	56.4	246.3	48.8	483.6	115.0

The results as presented above produced active debates between the various committees and key decision makers. There was however consensus that in terms of LIFT the British Hawk and the Italian MB339FD were certainly the frontrunners. The SAAF felt that that from a long term affordability point of view the Italian MB339FD aircraft would be the preferred option in terms of LIFT as the aircraft required less maintenance. The MB339FD did not however have dual capability, i.e. it was primarily a trainer and could not easily be converted into an operational combat aircraft. The Hawk on the other hand could easily be converted from a trainer to an operational combat aircraft with limited capabilities. Notwithstanding, the SAAF foresaw long-term budgetary constraints as they would have to pick up the tab from their annual budget allocation for the maintenance of whichever aircraft was acquired. The results of the technical evaluation revealed that that the Hawks required more maintenance and would operate at a higher cost than all the other aircraft on offer, whereas the MB339FD was the most affordable. It must however be remembered that the final decision did not rest with the SAAF although they would be the ultimate beneficiaries of the aircraft. Essentially the final decision would be made by Cabinet on the recommendations of the Ministers involved: i.e. Minister of Defence, Minister of Finance and Minister of Trade and Industry. The ministerial consensus was based on what was termed “national strategic considerations” rather than affordability.

The Ministers therefore took into account the trading relationship between South Africa and the UK as well as the industrial participation programmes which the UK offered as part of their package. It was therefore decided that the preferred bidder, in terms of the LIFT programme would be UK's BAe Hawk. In this regard it was noted by the ministers that "the decision to recommend the Hawk was based on national strategic considerations for the future survival of the defence aviation sector and the best teaming-up arrangements offered as well as strategically important industrial participation programmes offered with the best advantage to the state and local industries were also a determining factor in the final recommendations for the preferred bidder."⁴³

The process in determining the preferred bidder for ALFA was based on the same principles as enunciated above. BAe/SAAB with their Gripen emerged as the preferred contenders notwithstanding the fact that their offer was not the most cost effective and as with the Hawk, the Gripen to is a relatively high maintenance aircraft. According to the Joint Report on Strategic Defence Packages the reasons for the decision by the Ministers to accept the Hawk/Gripen combination were the following:⁴⁴

- When considering the two groups of possibilities with regard to the links between trainers, advanced trainers and advanced fighters, the combination of the Hawk/Gripen procurement option offered a more effective overall possibility of achieving technologically advanced National Industrial Participation projects that was more favourable than the other offers;
- The fact that the procurement could be packaged through a single export credit agency was beneficial;
- The considerable structural changes in the European defence industry and the resultant longer-term trajectory of that industry that Government would have to deal with in the future; and
- The fact that the design of the selected option was seen as beneficial to the Department of Defence.

Cabinet discussed the matter and resolved that the recommendations on the preferred suppliers for the strategic defence equipment be accepted as recommended as an interim step and that the Department of Defence, Finance, Public Enterprises and Trade and Industry proceed with further detailed negotiations with the preferred suppliers.

This was done with a view to achieving affordable agreements. In relation to the final projected costs of the procurement programme, it was noted that the total cost of the procurements comprised a number of elements, namely:⁻⁴⁵

- Costs of the actual military equipment as procured from the suppliers (i.e. the tender of contract price).
- Statutory costs which consists of items such freight, insurance and taxes, the largest portion of which would be incurred in South Africa.
- Project management costs incurred by the Department of Defence and Armscor in the managing of procurements.
- Financing costs for deferring payments to suppliers so as to fit an optimum cash-flow schedule more closely.
- Export Credit Agencies (ECA) premiums which are payable on all ECA-backed loans.
- Escalation on all of the above payments made in future years.

These costs were presented to Cabinet but did not take into account all the elements as described above for each and every package. Consequently, the total full cost was substantially higher than that originally presented to Cabinet. The estimate for both ALFA and LIFT came to R19, 620 billion, which was R4, 017 billion more than the R15, 603 billion originally approved by Cabinet.⁻⁴⁶

The next phase of the procurement process was the negotiation phase. In November 1998, the International Negotiating Team was constituted by Cabinet with the brief to negotiate an achievable funding arrangement and an affordable package with the identified preferred suppliers, which would result in the final contracting for the offered strategic defence equipment to the SANDF. The negotiating team were comprised of members of the Department of Defence, Department of Finance, The Department of Trade and Industry and Armscor, and was lead by a Chief Negotiator appointed by the Deputy President. One of the first challenges the negotiating team had to deal with was the fact that the project teams had now indicated that there was an overall increase in the procurement costs than was originally presented to Cabinet. It was claimed that the increases in costs were directly related to the technical performance of the equipment and programme management costs associated with equipment acceptance.

As a result of the increases the Department of Defence undertook to ensure that all technical-performance related costs would be accommodated within the programme costs as approved by Cabinet.

However, it was proposed that all programme management costs should be addressed outside the approved procurement costs. The programme management cost which was not included in the cabinet figures for ALFA and LIFT totalled approximately R250 million. As a result of the high costs and other factors including the timing and need for the equipment, the current operational capabilities of the SAAF, the fact that the SAAF still had a fully functional fleet of Cheetah fighter aircraft, and the fighter pilot capacity of the SAAF, the negotiating team recommended to the Ministerial Committee that the procurement of the ALFA be deferred and that a new strategy be embarked upon in terms of which the procurement would involve the acquisition of both the Hawk and a limited number of Gripens under a single contract with one supplier. Their alternative recommendation would essentially involve engaging the suppliers in a negotiation of a deferment of the procurement on the terms and conditions which were practicable and favourable, failing which the tender would be scrapped. The negotiating team presented their recommendations to the Ministerial Committee and convinced the Ministers to defer the decision regarding the procurement of the Gripens in terms of ALFA and allowed the negotiating team to endeavour to conclude a single contract with BAe for both the Hawks and the Gripens.

As part of the negotiation phase an Affordability Team was established. The Affordability Team conducted a comprehensive analysis of the economic, fiscal and financial impact of the procurements on the country, and used the macroeconomic model of the Bureau of Economic Research at the University of Stellenbosch to test and develop alternative scenarios. One of the most significant factors which came out of their report which was compiled and produced by the Affordability Team in August 1999 showed that the South African government was fully exposed to the depreciation of the Rand against foreign currencies, which accounted for approximately 75% of the total purchase price. There was no effective means of hedging the currency risk inherent in the procurements. Although the forward exchange rate used in the affordability assessment incorporated a premium for exchange rate risk, there was clearly a possibility that the currency depreciation could be even more rapid.

Should this happen, additional costs would be for the account of the government, with the obvious implication that the costs of the packages and their financing could be considerably higher than expected.

With the question of affordability and currency vulnerability in mind, the negotiating team approached BAe/SAAB to explore the possibility of them supplying the Gripen at a time in the future on condition that this would not lead to a price premium or technological obsolescence and that they would continue to deliver in terms of their industrial participation commitments. BAe however proposed an alternative strategy in terms of which they would supply 24 Hawk and 28 Gripen aircraft on a tranching basis. This offer would involve the supply of a number of Hawk and dual-seater Gripen upfront with an option for the government to cancel the procurement for the remaining aircraft.

BAe's tranching options can be summarised as follows:⁴⁷

	Tranch 1	Tranch 2	Tranch 3	Total
Equipment:	12 Hawk 9 Gripen	12 Hawk	19 Gripen	24 Hawk 28 Gripen
Payment dates:				
First	2000	2002	2004	
Final	2009	2006	2011	
Total Price	R6 565 000 000	R1 292 000 000	R5 316 000 000	R13 173 000 000
Unit cost:				
Hawk	R213 000 000	R108 000 000		R161 000 000
Gripen	R445 000 000		R280 000 000	R333 000 000
Margin above / below average cost:				
Hawk	+35%	-33%	-	-
Gripen	+34%	-	-16%	-

(Price stated at an exchange rate of: R6.25 = R1US\$)

An analysis of the BAe proposal reveals that the costs of the aircraft in tranche 1 were 35% and 34% higher than the average cost for the Hawk and the Gripen, respectively. The reason for this was that BAe/SAAB front-loaded their non-recurrent expenditures for the full contract on tranche 1. The implication of this was that the option to cancel would involve a large implicit cost. Therefore exercising the cancellation would effectively mean that the Government would pay a premium of 35% and 34%, respectively which would equate to a total (then) of R1, 736 billion.

Exercising the option to cancel the single-seater Gripen in 2004 would imply a major waste of resources as the only purpose of acquiring the dual-seater was to train pilots to fly the single seater.

The SAAF was however of the opinion that if the Government was committed to proceeding with ALFA and LIFT as originally envisaged, the programmes should not be amended. The Chief of the SAAF noted that the LIFT and ALFA aircraft should be viewed as a total system management approach meaning that any scenario that does not include all components of the system could not be supported. The scaling down of the number of aircraft available to train pilots was a risk, the dual-seater Gripen would not have the full operational capability of the single-seater and, consequently would not have the same deterrent value. As a result, without delivery of the second and third tranches, the operational fighter capability of the SANDF would be severely limited by 2010. In order to keep the costs within the limit approved by Cabinet, a further review of the programmes were concluded. As a result of this review it was revealed that some essential functionalities of the aircraft in the LIFT and AFLA package were not included in the contracts. It was therefore recommended that additional funding would have to be sought from outside the Cabinet approved package to fund these essential functionalities. This in fact meant that these additional costs would have to be recouped from that budget of the Department of Defence. It therefore appears that all the additional costs including the programme management costs and essential elements as mentioned above, were not presented to Cabinet initially. Based on the information presented to it, including the alternative option by BAe/SAAB, Cabinet approved an amount of R29, 992 billion as the total price for the military equipment (including corvettes, submarines and helicopters) on a tranced basis. In relation to ALFA and LIFT, this amount included two options for the government to cancel in 2002 and 2004 respectively.

Therefore for ALFA and LIFT the tranches would consist of the following:⁻⁴⁸

Tranche One: - 12 dual-seater Hawk trainers and 9 dual-seater Gripens from BAe/SAAB;

Tranche Two: - 12 dual-seater Hawks from BAe/SAAB with an option to cancel, which had to be exercised by the Government by 2004;

Tranche Three:- 19 single-seater Gripens from BAE/SAAB with an option to cancel, which had to be exercised by the government in 2004.

In addition Cabinet granted the permission required by the Department of Trade and Industry to sign supply non-defence (national) industrial participation, defence industrial participation and umbrella agreements for: twelve Hawk 100 trainer aircraft (Tranche 1), nine dual Gripen fighter aircraft (Tranche 1), twelve Hawk 100 trainer aircraft (Tranche 2) and nineteen single Gripen fighter aircraft (Tranche 3). According to the contract, the nine dual-seater Gripen aircraft would have to be delivered from July 2007 and the nineteen single-seaters from August 2009. The rationale behind this decision was that the air force had approximately 50 supersonic Cheetah fighter aircraft which were fully operational and able to operate to 2012 at which point it would be fully replaced by the Gripen. Accordingly, on the 3 December 1999 the umbrella agreement incorporating the LIFT supply terms as well as the associated NIP and DIP agreements were signed and was essentially a combined programme incorporating the ALFA and LIFT projects.⁴⁹

Procurement for the remaining equipment i.e. the submarines, corvettes and helicopters were concluded essentially along the same lines and procedures, *mutatis mutandis* as the ALFA and LIFT programmes were. The final deal comprised the following:

- 4 corvettes and 3 submarines from the German ship building consortia ThyssenKrupp and Ferrostaal;
- 28 Gripen fighter aircraft and 24 Hawk lead-in fighter trainer aircraft from Anglo-Swedish company BAe/SAAB;
- 4 Super Lynx naval helicopters from the UK company GKN Westland and
- 40 utility helicopters from the Italian Augusta company.

Chapter 4

4.1 Financial Arrangements

4.1 Financial Arrangements

Having decided on a wish-list of military hardware and preferred suppliers, the South African Government was now faced with the reality of financing their state-of-the-art equipment. The price tag for the entire package as proposed and approved by government was an estimated R30 billion. It is interesting to note that Minister of Finance, Trevor Manuel was initially less enthusiastic about the proposed acquisition than his colleagues in Cabinet and at the time insisted that the deals should be more affordable.⁻⁵⁰ However, as will later be seen the Minister probably had a “Damascus experience” as he became a fierce proponent and defender of the Arms Deal and was the voice of government in a subsequent Court application to by Economist Allied for Arms Reduction –SA (ECAAR) to try to have the arms deal set aside.⁻⁵¹

As a result of the Finance Ministers’ initial concerns about the affordability of the deal the government carried out a review and commissioned senior ANC politician, Jayendra Naidoo to carry out the review.⁻⁵² The review proposed that the purchases be scaled down from R30 billion to R21 billion. The government initially conceded and accordingly cancelled the order for the four Super Lynx naval helicopters. It is important to note that the proposed purchase of these naval helicopters were to supplement the corvettes as each corvette came equipped with a helipad. Government therefore made it quite clear that the cancellation of the naval helicopters were temporary as the corvettes required the helicopters to achieve its required efficiency as a fully functional naval vessel. The government, in an attempt to bring the costs down to the recommended R21 billion also cut the order for the Italian helicopters from 40 to 30, confirmed the orders for the nine Gripens and twelve Hawks but deferred the acquisition of the remaining nineteen Gripens and twelve Hawks, until such time as suppliers made good on their promises of offsets and, if the economy could accommodate the further acquisition at a later date. This measure did not sit well with the Defence Minister Joe Modise and after some lobbying the full complement of armaments were once again fully reinstated and the price-tag was back to its approximate amount of R30 billion.

The Minister of Finance, from initially showing concern about the affordability of the deal was now miraculously backing the deal and in the later part of 1999 announced that he had managed to secure unprecedented favourable financial arrangements with German, Italian, French and UK banks and credit agencies to facilitate the proposed arms acquisition. The Minister claimed that the terms of the agreements were highly attractive and allowed for the repayment to be amortised over a 14 year period at preferential interest rates.⁻⁵³ Although the full details of these loan agreements were initially never released, it was clear that the Banks were able to finance the acquisition mainly due to the UK's Export Credits Guarantee Department underwriting the various loan agreements.⁻⁵⁴

The Export Credits Guarantee Department ("ECGD") is a separate UK Government Department reporting through a Minister of State to the Secretary of State of Business, Enterprise and Regulatory Reform and is the United Kingdom's official Export Credit Agency ("ECA").⁻⁵⁵ The ECGD derives its powers from the Export and Investment Guarantees Act of 1991. The ECGD's aim is to benefit the UK economy by assisting exports of UK goods and services to win business, and UK firms to invest abroad, by providing guarantees, insurance and reinsurance against loss.⁻⁵⁶ The ECGD is required by the UK government to operate on a better than break-even basis, charging exporters and primary financiers premium at levels that match the perceived risks and costs in each case. The largest part of the ECGD's activities involves underwriting long term loans to support the sale of capital goods such as aircraft, defence equipment, civil engineering services, machinery and other services and to help UK companies take part in major overseas projects such as the construction of dams, oil and gas pipelines, airports and power stations. Notwithstanding, the proportion of the ECGD's business in support of Defence exports has ranged from 30% to 50% in recent years.⁻⁵⁷

For the first time the ECGD Annual report for 2000/1 lists guarantees issued listed guarantees issued in that financial year.⁻⁵⁸ The report revealed that the trainer /fighter aircraft acquisition programmes were covered by a guarantee of £1, 679,9 million. This equates to 49% of the total of all guarantees issued in that financial year.

Despite attempts for many interested parties (mainly objectors to the deal) to obtain more details regarding the financial agreements, government refused to provide exact particulars, except to reiterate that the financial arrangements contained favourable terms and was provided at preferential interest rates.

It was only until one of the objectors; the ECAAR launched an application in the Cape High Court to stop the deal that further particulars regarding the financial arrangements emerged. Responding a responding affidavit the Minister of Finance, Trevor Manuel listed the following foreign loan agreements entered into by the Government in 2000 in relation to the arms acquisition:⁻⁵⁹

- a) with AKA Ausfuhrkredit-Gesellschaft mbH, Commerzbank Aktiengesellschaft and Kreditanstalt für Wiederaufbau and a further agreement with Societe General and Paribas with respect to the corvettes;
- b) with AKA Ausfuhrkredit-Gesellschaft mbH, Commerzbank Aktiengesellschaft and Kreditanstalt für Wiederaufbau and a further agreement with Societe General and Paribas with respect to the sub-marines;
- c) with Barclays Bank plc and the UK's Secretary of State of Business, Enterprise and Regulatory Reform acting for the ECGD in respect of the Gripens and Hawks; and
- d) with Mediocredito Centrale SPA with respect to the helicopters.

According to the Minister of Finance the non-UK export agencies had submitted a proposal to underwrite the above finance agreements and had even matched the offers by the ECGD. The ECGD, however arranged a further, more attractive offer than its competitors which clinched the deal. As a result all of the finance deals were underwritten by the ECA. The Minister, in an attempt to justify the deal argued that he had three choices to raise the necessary finance for the acquisition: he could either raise taxes, build the amount needed into the Government's normal borrowing requirements, or he could use ECA finance arrangements.

By opting for the last mentioned option, the Minister argued that he made a saving over R600 million.⁻⁶⁰

When the deal was concluded the Government claimed that the impact of the purchases on the budget would be relatively attenuated and entirely manageable. The Naidoo review team however stated that an impact on the budget would be inevitable and as a result thereof there would be a shift away from social expenditure as well as mounting economic, financial and fiscal difficulties.⁻⁶¹

In February 2002 the government estimated that the total cost of the project would be R52,7 billion, or about R3,7 billion a year on average over the life of the programme.⁶² This would in effect mean that the purchases would increase military spending by about a third. It was calculated that the defence budget, including the Special Defence Account would rise by 15% per annum between 1999 and 2004, noticeably higher than the annual rise of inflation as well as the increase in budget of some key departments like education and health. The difference between the R30 billion figure of 1999 and the nearly R53 billion of 2002 estimate was accounted for partly by inflation and interest payments, but there was also a concern about the exchange rate, which had become sharply adverse. In 1999 the rand stood at 6 to the dollar, but by early 2002 it had fallen to 10, and there was a similar decline in its sterling value, from 10 to over 15 during 2002. With the sharp fall of the Rand against major currencies there was stark disagreement over the impact of the cost of the programme with some economists predicting that by 2010 the estimated costs would reach as much as R300 billion.⁻⁶³

Chapter 5

Offsets / Industrial Participation

5.1 Industrial Participation in South Africa

One of the major justifications used by the government to defend the arms purchases was the fact that in return for their acquisition the country would receive the equivalent of more than twice the amount spent in the form of counter trade and investments. The government continually stressed the potential positive effects of the proposed industrial participation (IP) offers on investment, job creation and growth in the local-defence industry and the national economy. At the time of approving the arms procurement programme the government stated that foreign suppliers had made IP offers worth R104 billion which would result in the creation of more than 65 000 jobs over a period of 7 years.⁶⁴ Some commentators have however argued that the South African government has ignored the cost implications of the procurement and focussed their attention more on the promises of offsets.

Offsets or Industrial Participation (IP) as it is officially referred to in South Africa, became mandatory for all government purchases in September 1996. The Department of Trade and Industry defines Industrial Participation (in the South African context) as a programme that seeks to leverage economic benefits and support the development of South African industry by effectively utilising the instrument of government procurement.⁶⁵ A more general definition is that an offset is a contract imposing performance conditions on the seller of goods or services so that the purchasing government can recoup, or offset, some of its investment. In some way reciprocity beyond that associated with normal market exchange of goods and services is involved.⁶⁶

5.2 The nature and Forms of Industrial Participation

A distinction is drawn between direct industrial participation, which includes goods and services for the equipment that the purchaser is buying (e.g. the supplier sources parts of the weapons system from the purchaser) and indirect industrial participation, which includes goods and services unrelated to the specific equipment, and can include foreign investment and counter trade (barter counter purchase and buy back).⁶⁷

The Spanish bid for the corvette contract, for example, had been supported by an offer to buy South African coal and fish.

In the present deal, the purchases would consist mainly of industrial components, such as converters (using South African platinum) and other parts for Swedish cars, railway equipment and avionics for civil aircraft. Also included would be the work done by South African subcontractors on the purchased ships and planes, and the sale of parts for other UK and Swedish arms products, such as display units for the Gripen fighters and gearboxes for Rolls-Royce aero engines.

It is also possible to agree to inward investment unrelated to the purchase of the goods. Such industrial participation deals are an increasingly important part of the international trade in military equipment, especially in the aerospace industry.

The nature of industrial participation agreements in relation to the procurement of military equipment will depend on the type of buyer. In the case of a country with a defence industry, the emphasis of industrial participation will often be on limiting the impact on the domestic industry by the reallocation of economic activity from the supplier country to the purchasing country, including technology transfers. This reallocation of economic activity may also be linked with industrial participation that focuses on non-military products.⁻⁶⁸

In April 1997 cabinet approved National Industrial Participation (NIP) policy and operating guidelines for all government departments and parastatals to be administered by the Department of Trade and Industry (DTI). NIP effects all government and parastatal purchases or lease contracts (goods, equipment and services) with an imported content equal to or exceeding US\$ 10 million (or the equivalent thereof) are subject to an Industrial Participation obligation. The IP obligation must equal or exceeds 30% of the value of the imported content of the purchase or lease and must be fulfilled usually within 7 years from the effective date of the IP agreement.⁻⁶⁹ The prospective foreign seller/supplier has to submit and implement business projects, which would generate IP credits equalling or exceeding the 30% IP obligation. A 5% performance guarantee is required prior to the IP contract being awarded.

It is interesting to note that at the initial stages of the deal the DTI was however demanding 80% offsets and the Ministry of Defence wanted 50% and if possible 100% on military contracts. This was done on the basis that the government of Hungary, entered into a lease agreement for Gripen fighters and managed to extract 110% NIP from the Swedes.⁻⁷⁰

As mentioned above the definition and mission of the NIP policy is to leverage economic benefits and support the development of South African industry by effectively utilising the instrument of government procurement. According to the DTI the stated objectives of the NIP policy are: sustainable economic growth; the establishment of new trading partners; the generation of foreign inward investment; increasing exports of “value added” goods and services; research and development collaboration; job creation; human resource development; technology transfer; and the creation of economic advantages for previously disadvantaged communities.⁻⁷¹

5.3 Arms Acquisition and Industrial Participation

Defence Industrial Participation (DIP) relates to the IP obligations which are imposed by government in respect of the procurement of all military equipment which is administered by Armscor. The DIP policy for purchases by the Department of Defence (DoD) has further objectives more focused on the defence-related industry. Its stated aims are to retain and create jobs; allow a sustainable defence industrial capacity with strategic logistic support capabilities; to promote value added arms exports; to promote like-for-like technology transfers and joint ventures and to maintain skilled indigenous manufacturing capabilities.⁻⁷²

In relation to South Africa’s arms procurement programme the total IP commitments (DIP and NIP) were valued at R104 billion, although it is claimed by the government that the actual economic benefits deriving from these commitments is expected to amount to almost R70 billion over a period of 11 years. The IP commitments are divided into 3 categories:

- i. Direct offsets: defence related offsets (about 20% of the total, or about R14,5 billion) including direct purchases from the local defence industry (R4 billion); technology transfers (R3 billion) and export orders for local defence firms (R7,5 billion);

- ii. Indirect offsets: counter-purchase by the foreign defence suppliers of non-defence goods and services from South Africa (about 45% of the total, or r31 billion);
- iii. Inward investment in South Africa's defence and non-defence industries by foreign suppliers and other companies associated with suppliers (about 35% of the total, or R24 billion).⁻⁷³

5.4 The Value of South Africa's Defence-Related Industry

In terms of the total IP commitments there is a split between NIP and DIP. The government estimates that at least R14,5 billion will be spent directly in the local defence-related industry with the balance of R89,5 billion to be spent on non-defence activities, including indirect offsets and inward investment. Each of the arms acquisition programmes carries a 5% penalty clause for non-delivery on NIP and DIP projects and activities.

In theory the direct DIP activities will result in foreign suppliers purchasing certain locally manufactured inputs (e.g. sub-systems, components) from the domestic defence industry, which will then be integrated into the new weapons systems. In some of the programmes significant parts or sub-systems of the new weapons systems will be manufactured locally, either under licence or in collaboration with the foreign suppliers. The foreign suppliers will contract directly with the local industry and will take final responsibility for the weapons systems before they are delivered to the SANDF. It is therefore claimed that these direct DIP activities are likely to have a positive impact on the fortunes of certain sectors of the local defence-related industry. However, the costs of these direct DIP activities will probably be higher. This is due to the fact that the foreign suppliers have an incentive to raise their prices to include the price of the offsets and the penalty clause, and the fact that there are no market prices of standardised goods in the defence market.

The indirect DIP activities (once again, in theory) will result in some of the foreign suppliers investing (through equity purchases) in certain local defence companies and/or setting up new production assembly facilities for other defence products and services.

A number of the suppliers may also help South African defence firms to win export contracts, and/or integrate South African inputs (e.g. technology, sub-systems) into their weapons systems for sale in foreign markets.

5.5 Local Purchases from the Defence-Related Industry

The arms acquisition programme involves the purchase of significant quantities of new weapons systems for the Navy and Air Force. These purchases have a significant impact on the maritime, naval shipbuilding and aerospace sectors and sub-sectors of the local defence-related industry. However, the local industry is considerably smaller, more concentrated and financially weaker than it was in the late 1980's as a result of the defence cuts and increased foreign competition.

The downturn and restructuring of the industry has led to a loss of capabilities, including skilled human resources in many sectors and sub-sectors of the local industry and have struggled to identify worthwhile direct and indirect DIP activities in the sectors and sub-sectors of the local industry. South Africa's maritime and naval shipbuilding industry, which is concentrated in Durban and Cape Town, has downsized quite dramatically in recent years. The country's only naval shipyard, Dorbyl Marine, closed down in the early 1990's due to poor trading conditions.⁷⁴ The industry thus lacks the capacity to design and manufacture naval ships although a few companies have the capacity to design and manufacture small harbour patrol boats and tugs. The local maritime industry does however have a limited capacity in naval electronics (including shipborne radar systems), systems integration (combat suites), ammunition (including naval bombs and mines), research and development and ship repair and maintenance. Overall, however this sector is not particularly well placed to benefit from the Navy's acquisition programmes without significant investments to upgrade and expand its existing capabilities.

South Africa's aerospace industry, which is concentrated in a few companies in Gauteng, has a relatively well-developed capacity to design and manufacture missiles, aerospace engines and fixed and rotary wing military aircraft. The industry also has significant capabilities in electronics (including radar), avionics, systems integration, weapons systems, and ammunition.

Likely beneficiaries of the European suppliers' local purchases for the Air Force's acquisition programme include companies such as Denel Aviation, Grintek, ATE, AMS and Aerosud. AMS is expected to supply health and usage monitoring systems for the Augusta helicopters and some of the electronic equipment on the Gripen fighters. Denel Aviation has been awarded a R282 million contract to design, develop and manufacture weapons-carrying pylons for the local Gripens to be acquired as well as for those Gripens to be exported by SAAB. In addition, Augusta offered Denel Aviation licence rights to manufacture the A109 helicopter in South Africa, the right to source components for the helicopter from local industry, and to perform complete maintenance of the A109 in South Africa. Overall, Denel is likely to gain up to R7,5 billion in new business as a result of the arms acquisition.⁸⁴ This sector of the defence-related industry is therefore potentially well placed to benefit from the Air Force's acquisition programmes.

5.6 Investment, Joint Ventures, Technology Transfer and Exports

In recent years most of South Africa's foreign investment has been linked to short-term speculative investments in bonds and equities. Notwithstanding large inflows of short-term capital there has been very little long-term fixed direct investment, which is the kind of investment that is needed to compensate for South Africa's low level of domestic saving and to create jobs.

As a result of the finalisation of the arms package, a number of European defence companies, including the preferred suppliers, have made investments in local defence companies, particularly in aerospace and IT companies.

Most of the investments have involved equity purchases, rather than investment in plant and capital. BAe systems has acquired the majority shareholding in Gauteng based software company, Paradigm Systems Technology, and acquired a 20% stake in Advanced Technologies and Engineering (ATE), a leading local aerospace company. BAe also acquired a 20% equity stake in Denel's aerospace division, which will form the basis for a new aerospace company with ATE and Aerosud. In 1999 Altech sold the remaining 50% of its defence business, African Defence Systems to French company Thomson CSF, which had purchased the initial 50% in the company the previous year. In March 1999 Swedish company Celsius purchased 49% of Grintek Avitronics for R30 million. Vickers, the UK engineering firm, has purchased Reumech OMC the armoured vehicle division of Reunert.⁻⁷⁵ These equity investments are linked to the arms purchases from countries such as Germany, Italy, Sweden and Britain and it is claimed by both the South African and European Union governments that these transactions are part of larger initiatives to promote increased trade between South Africa and Europe.

5.7 Non-Defence Industrial Participation

Government, through its NIP policy, has attempted to use the defence purchases to leverage substantial investment in the non-defence sectors of the South African economy. It has attempted to direct these investments to particular sectors of the industrial economy, like minerals and energy, and to specific parts of South Africa such as Kwazulu-Natal, the Western Cape and the Eastern Cape. It has also attempted to link it with other national economic and industrial policy initiatives (e.g. the DTI's Spatial Development Initiatives and Industrial Development Zones).

In September 1999 the government released some details of foreign suppliers' NIP offers which included:⁻⁷⁶

- The construction of a mini-steel mill by the German Frigate Consortium, to supply technology for a new crank shaft foundry (at ADE in Cape Town) and to source automotive components from South Africa for the overseas markets. A number of other projects relating to cosmetics, gold refining, chromex mining and the production of textiles and plastic components were also under consideration.

- The German Submarine Consortium was offering to invest in the construction of a stainless steel plant and a stainless steel fabrication plant.
- Augusta, the Italian company supplying the light utility helicopters, was offering to invest in the construction of a special steel mill to produce products for tool bearing, engineering and forging steels. The company's NIP offer also included investments and technology transfers in gold jewellery manufacturing, mohair and ostrich skin products. In addition they were likely to offer Denel a licence to assemble locally and manufacture parts and components for Augusta's K119 Koala civilian helicopter.
- BAe/SAAB was offering investment and the establishment of joint ventures, including technology transfers between British, Swedish and South African companies in the military and civilian aerospace sectors as well as in mining equipment, remote control systems, household products, electrical equipment, spring manufacture, wax production, motor vehicles (Volvo & SAAB), GSM base stations and fish processing.

Many critics of the arms deal have however argued that the offsets relating to non-defence sectors involve the purchasing and exporting of raw materials or produce that would have been exported anyway. A good example of this is that of the unsuccessful Spanish proposal: the Spanish submitted a bid to supply the corvettes and as part of their proposal promised substantial investments in South Africa's fisheries industry. Notwithstanding the fact that the Spaniards were unsuccessful in their bid to supply the corvettes they nonetheless proceeded with part of their planned investment in the fisheries sector.

The largest single proposed investment was the project for the new stainless steel plant at Coega on the coast of the Eastern Cape. German Steel and engineering companies involved in the corvette and submarine consortia proposed to invest R6 billion in this scheme. This project however drew huge criticism at the time it was proposed with critics arguing that the steel plant would be largely superfluous, since South Africa produced far more than it could consume and the international market for steel was saturated.

Another factor which militated against the project was that that a new deep water harbour would have to be constructed to compliment the steel plant, the cost of which would be for the South African government's account to the tune of approximately R1,5 billion and, would in itself be redundant and environmentally damaging. The project would be capital intensive and would generate no more than one thousand permanent jobs. The proposed project was eventually dropped with the government allowing the offset credits to be transferred to another controversial project; being the proposed aluminium plant also situated in the Eastern Cape. The problem with aluminium plants is that they are monster consumers of electricity and water which would no doubt have to be subsidised by the government. Given the current electricity crisis the country is experiencing it is highly unlikely that an aluminium plant will function efficiently.



Chapter 6

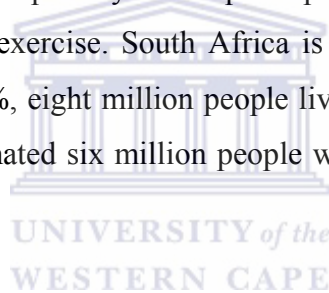
The Arms Deal – Critique

Article 51 on the United Nations (UN) Charter recognises that every state has a right to individual and collective self-defence. However the UN Charter also requires all member states to promote universal respect for, and observance of, human rights and freedoms in order to achieve economic and social progress and development (Article 1,55 and 56) and to promote the establishment and maintenance of international peace and security with the least diversion for armaments of the world's human and economic resources' (Article 26). A majority of states have, in addition, ratified the International Covenant on Economic, Social and Cultural Rights to contribute to the progressive realisation of these rights through international assistance and co-operation. The Millennium Development Goals (MDGs) agreed in September 2000 by all UN member states will not be achieved if resources are diverted from this vital task by inappropriate arms transfers. According to a comment by a senior official of the World Bank, there is a fundamental imbalance with the world spending US\$900 billion on defence, around US\$ 325 billion on agricultural subsidies and only US\$50 billion on aid.⁷⁷ The countries of Africa, Latin America, Asia and the Middle East hold 51% of the world's heavy weapons.⁷⁸ This is a serious impediment which undermines economic growth and development in these countries, where it is most needed. It is however shocking how few governments make serious attempts to consider the impact on development of their arms imports and exports. The result of paying mere lip service to the commitment of social upliftment means that scarce resources are being diverted from the fight against poverty and million are suffering as a result.

The transition from apartheid to democracy has been no less than a miracle and was a euphoric experience for all the peoples of South Africa. Although the country basked in the world's limelight there were some serious and immediate challenges which had to be addressed by the new government. Years of social and financial inequality left the majority of South Africa's population reeling in poverty.

Besides inheriting an almost bankrupt government, the new government also faced the problem of having to deal with many socio-economic problems; crime, the lack of adequate housing and sanitation, unemployment, the lack of adequate health care and the scourge of HIV/Aids were (and still is) just a few of the many problems which the government had to devote serious attention to.

With the build-up to South Africa's first democratic election and even prior to that, when attending mass rallies and "illegal" political gatherings, it was comforting to hear the countries future leaders confirm that, if elected, they as a government would redirect government spending to social development and upliftment. In 1990 Mosiuoa Lekota stated that in post-apartheid South Africa the ANC would channel money towards improving the standards of living and creating jobs for people instead of pumping millions of rands into the army.⁻⁷⁹ It therefore remains unconscionable that the first major procurement priority of the post-apartheid government was to embark on an arms procurement exercise. South Africa is a country with an unemployment rate of approximately 40%, eight million people live in informal settlements, and is a country in which an estimated six million people will die of Aids-related diseases by the year 2010.⁻⁸⁰



It is hard to believe but research shows that developing countries are usually the biggest spenders when it comes to purchasing arms. Throughout the 1970's, arms sales to the developing world were financed by low-interest loans. When global interest rates were raised in the late 1970's and 1980's, a mountain of debt impoverished many developing countries. War and unrest has further plunged some of these countries even further into debt. Many critics have argued that many first world countries rely heavily on exporting of arms and also required valuable natural resources found mainly in developing countries. The argument goes that first world countries therefore use arms exports to deliberately entrap third world countries in a spiral debt, thereby gaining access to exploit those developing countries economies and their natural resources. For states like El Salvador, Ethiopia, Mozambique, Somalia, Sir Lanka, Sudan, and Uganda, involvement in military conflict has been a major cause of indebtedness. Of the more than 150 wars fought between the end of the Second World War and the mid 1990's, more than nine out of ten occurred in the developing world.

Wars also exacerbate the effects of famine and can severely impede the delivery of aid to bring relief. Examples include Chad (1984), Ethiopia (1984, 1987 and 1998), Mozambique (1984, 1987), Somalia (1984), and Sudan (1984, 1998). By 1994, it was established that one-fifth of the developing world's debt was due to arms imports.⁻⁸¹ Developing countries governments continue regularly to commit huge proportions of their meagre national budgets to military expenditure. Often the only figures available for analysis in some of these countries are military expenditure, which includes salaries and infrastructure costs, as well as the costs of arms imports.

In certain developing countries, governments spend more on military than on social development, communications and infrastructure, and health combined.⁻⁸² Even where such countries have been developing their own domestic arms industries, expenditure on arms imports is high.

France, the Russian Federation, Germany, Italy, the UK and the USA are the world's biggest exporters of arms and are together responsible for 88% of conventional arms exports. The USA and its European counterparts dominate the industry contributing to most of the world's exported weapons. In 2002, arms deliveries to Asia, the Middle East, Latin America, and Africa constituted 66,7% of the value of all arms deliveries worldwide, with a monetary value of nearly US\$17 billion.⁻⁸³ The five permanent members of the UN Security Council accounted for 90% of those deliveries. These figures illustrate that the arms market is big business, even in regions with a high proliferation of developing nations. Across these regions more than a billion people struggle to survive on less than a dollar a day; one child in five has not completed primary school, more than 14 million children lost one or both parents to Aids in 2001, nearly 800 million people were suffering from chronic hunger, and five hundred thousand woman died in pregnancy or childbirth.⁻⁸⁴

The misuse of arms does impede development. Irresponsible arms transfers encourages unaccountable and poorly trained military forces which are used by dictatorial regimes to suppress human rights and democratic development; facilitates brutal resource exploitation; contribute to environmental degradation; and to an increase in violence against woman.

In these cases, the development needs of the country continue to go unmet, and in some situations may increase still further. Poverty may deepen, inequalities may widen, access to basic services is further compromised, and livelihoods threatened. In addition, and increasingly in the wake of the “war on terror”, military aid, grants and loans are extended to developing countries. The costs and long term effects of having to service these loans and maintain the arms are usually devastating on these countries’ already scarce resources and in most cases leads to a vicious cycle of debt entrapment and economic dependency on first world countries. It seems that South Africa has fallen into the same trap that has plagued developing countries for decades. It is common cause and agreed that there is no military threat against South Africa, immanent or otherwise.

The country has however other real threats like the HIV/Aids pandemic which threatens and, is taking the lives of millions of South Africans each year. One therefore expected the incumbent government to address these and other social issues head-on and devote the country’s resources to the alleviation and eradication thereof. The new government however thought otherwise, their first priority was to purchase arms. The obvious question is: how did this thinking or policy come about? It is a well known and documented fact that dealing in arms is big business and almost all companies who manufacture and export arms are heavily backed by their governments. Negotiations for the sale and acquisition of the arms are usually done at ministerial level. During the research for this paper it became abundantly clear that the common thread running throughout the arms industry worldwide is the pursuit of money and the practice of corruption. It is safe to say that there have been no major arms deals concluded without rumours and allegations of corruption. Corruption is however, notoriously difficult and expensive to prove and arms companies have the means of creating webs of front companies and offshore bank accounts to hide their tracks. Transparency International (TI) estimates that bribery around the world robs about US\$ trillion from the poor and links the arms industry to about 45% of that corruption.⁻⁸⁵

After 1994, European politicians flocked to South Africa to pay tribute to President Nelson Mandela and the country’s new democracy.

That was however not their only mission, they also brought with them an array of armaments which they were eager to sell to South Africa. The idea of offsets in exchange for arms purchases is not a novel one, almost all major arms deals concluded worldwide since the Second World War involved the marketing ploy of offsets. It must be made absolutely clear that the South African government did not conceive the idea of offsets to justify their purchases but were rather, *inter alia*, bought over by the idea which was placed in their minds by the Europeans when they came with their offers of warships and warplanes. The royal yacht Britannia had reportedly doubled as a floating armaments industry exhibition when Queen Elizabeth visited Cape Town in March 1995. It is common knowledge that members of the royal family and successive British prime ministers are repeatedly employed to promote British arms exports in what Margret Thatcher described as “batting for Britain”.⁻⁸⁶ Despite the governments own affordability team warning cabinet that the multi-billion rand arms purchase was a highly risky proposition that could lead the government into mounting fiscal, economic and financial difficulties, the government ignored these warnings and went ahead and signed foreign loan agreements which some argue is a textbook example of third world debt entrapment by European banks and governments.

Arms companies and their governments are notorious for flaunting both international and domestic laws in order to sell their products. During the apartheid era the United Nations imposed an arms embargo against South Africa, however this did not stop countries like Israel from collaborating with South African arms companies to develop and export weapons. This type of behaviour has become acceptable and synonymous in the realm of international arms trading, where the only consideration is profit and nothing else. A century ago Sir Basil Zaharoff was the chairman of Vickers Armstrong munitions company and godfather of the modern BAe Systems. It is now a known fact that Zaharoff used bribery to fuel wars between Greece and Turkey and then between Russia and Japan. Zaharoff claimed that the key to making money in the armaments industry was to sell weapons to both sides and then create conflict between them.⁻⁸⁷ This tactic appears to be a firmly entrenched business tenant to which arms companies and their governments, to this very day adhere to.

6.1 Offsets or Scam?

Offsets, the promise of future investments as an inducement to trade, have been prohibited for civil trade transactions under the World Trade Organisation's (WTO) rules. Such agreements are outlawed in all government procurement (non-military) by Article XVI of the WTO Plurilateral Agreement on Government Procurement.⁸⁸ The prohibition flows from the recognition by the WTO that offsets distort normal market operations, are a barrier to trade, entices governments into making irrational and uneconomic purchases and is an invitation to corruption. However arms trade lobbying secured an exemption from that prohibition under the guise of "national security". Politicians frequently cite offsets to justify heavy expenditures on armaments, although experience has shown that the full promised benefits rarely materialise. There is overwhelming evidence in research material that shows that offsets: increase rather than decrease the costs of weapons acquisitions, distort market forces, can cause weapons proliferation, are almost impossible to monitor, are notorious for involving corruption and impedes rather than contribute to economic development. One of the biggest arms deals which took place in the late 1980's was a deal between the UK and Saudi Arabia known as the Al Yamamah arms deal which was worth approximately £43 billion. The Al Yamamah arms deal was supposed to create 75 000 jobs inside Saudi Arabia by way of offset investments. Now that the contracts are complete, it transpires that only 1 600 jobs were created, of which 1 300 were for expatriates and only 300 for Saudi Arabians.

The Centre for International Cooperation and Security, based on its own studies, argues that countries are likely to buy unnecessary and inappropriate equipment and the fact that arms are purchased in foreign currency may lead to serious indebtedness and the sale of natural resources on unfavourable terms.⁸⁹ They further argue that offset investments create little by way of new or sustainable employment, and tend not to result in significant technology transfers. In other words, offset investments are economically inefficient, requiring subsidies or complimentary investments in order to make them viable. The obvious problem here is that the recipient governments are saddled with the burden of providing these complementary investments which further siphons valuable resources away from more meaningful causes like social upliftment and poverty alleviation.

An academic study on offsets shows, *inter alia*, that:

- The use of offsets in contract negotiations means that contracts may not necessarily be won by the best equipment, as judged on price, performance and reliability. The WTO, the IMF and World Bank views offsets as problematic because they are market distorting, inefficient and are often designed to avoid the fundamental reform of economic structures necessary to generate growth (particularly in developing countries).
- Any costs incurred by the arms companies and their governments as a result of the offset deals are simply passed onto the recipient country by raising the contract price of the equipment sold. In other words, whilst some transfer of jobs and technology may well occur, the costs of offset investments are factored into the original contract price by defence companies. This is particularly the case where penalties are written into the contract for failure to meet offset obligations. Suppliers will invariably attempt to include the cost of such penalties in the original price of the defence equipment they are selling, effectively insuring themselves against the cost of non-compliance. Suppliers may then decide later on that it is cheaper to pay any fines arising from a penalty clause than it is to meet their offset obligations. Alternatively the reputational costs involved for both parties in admitting failure to achieve the offset requirements may encourage them to subsequently amend the original contract requirements by, for instance, extending the timeframe in which the offsets have to be delivered or by loosening the contract in other ways.
- The level of job creation and technology transfer over and above that which would have occurred without offsets may well be minimal.
- Even where offset work is placed with companies in a recipient state it may simply disappear at the conclusion of an offset obligation as it is moved elsewhere to satisfy the offset requirements demanded by a new customer. Consequently, not only do recipients pay more and get substantially fewer economic benefits claimed but many of these benefits may be short-term and fleeting.

- In cases where procurement decisions have been made as result of corruption offsets also represents potentially useful tool for the provision of illicit rewards (e.g. by the provision of an offset contract to a relative or associate of a key government official).
- Offsets can also provide apparent legitimisation for high levels of expenditure on prestige defence projects, which might otherwise not be authorised on the grounds of costs.⁻⁹⁰

The South African government seemed to have ignored these warnings and became overwhelmed by the prospect of spending R30 billion on arms in return for promised investments of R110 billion and the creation of 65 000 jobs. In fact, South Africa's attention was now not so much on the arms it was acquiring but on the offsets it would receive. Although research shows that offsets are really no more than a marketing ploy by arms companies and their governments to sweeten the deal and are not economically efficient, the South African authorities naively stated that they will ensure that their offsets are foolproof. The reality is however that offsets are inherently designed so as to benefit the suppliers and not the recipients, the first world countries know this and continue to use this method with great success when negotiating arms deal packages with third world countries, the South African deal being no exception. If one breaks down or properly analyzes the Spanish offset proposal for example, provided when they were tendering for the corvette contract one really sees a different picture as a study by Ekhart Kramer, the chairperson of the Deep Sea Trawlers Association reveals.⁻⁹¹

The Spanish promised to invest in the South African fisheries industry and their proposal involved the sale of thirty fishing trawlers to South Africa financed by loan interest rate loans, the construction of two fish processing plants at Lamberts Bay and Port Nolloth, and also guaranteed to export the throughput to Spain. Kramer found that the plants would require two hundred and fifty tons of hake per annum to be economically viable. South Africa's annual harvest amounted to only one hundred and forty thousand tons. Overfishing on such a large scale would result in the rapid collapse of the entire fishing industry that employs about eighty-five thousand people. The Spanish have however subsequently invested in the South African fishing industry but on a much smaller scale despite losing the contract to supply the corvettes.

As mentioned above, the major offset benefits were to be a stainless steel plant at Coega in the Eastern Cape where there is a very high unemployment rate. Environmental and financial studies have however shown that Coega may be a disaster in the making. The introduction of a steel plant, consuming large quantities of water would have devastating consequences for the existing agricultural sector in the area. The government would also have to supplement this “investment” by constructing a deep water harbour and provide subsidized electricity needed to run the plant. Furthermore, there have been persuasive arguments that the actual jobs which were supposed to be created by the project would be nowhere near the promised figure of 16000 as estimated in November 1998.⁻⁹² South Africa already has a well-developed stainless steel manufacturing capacity. The loss making Columbus project, which is the largest single site stainless-steel plant in the world, will have a planned output of 600 000 tonnes at full production and Iscor is currently expanding its stainless steel capacity by 480 000 tonnes. In the light of these developments and the uncertainties around export markets and the limited amount of jobs that have been created in these mega-projects, the obvious question is: does a stainless steel plant at Coega make any economic sense? Some studies have pointed out that the world market for stainless steel already suffers from excess production capacity, that the world price of steel is too low and therefore does not make the plant viable.⁻⁹³ Running such a plant will also be highly capital intensive, skills intensive requiring imports of skilled people.

Research has since concluded that it is extremely that 65 000 jobs will be created by the proposed projects and that there is more likelihood that the unemployment rate will increase instead of decrease. It is furthermore argued that offsets are a contradiction to South Africa’s constitutional requirement of Section 217 that all government procurements must be conducted in accordance with a system which is fair, equitable, cost effective and transparent.⁻⁹⁴

6.2 Corruption

It is now a know fact that the entire offset procedure and arms deal *per se* was riddled with corruption. As early as mid-1998 there were already rumours in the parliamentary corridors of a £1 million first success fee allegedly paid by BAe Systems to various MP’s.

This money was to entice the politicians to support the arms deal. In December that year trade unionists at the National Union of Metalworkers of South Africa (NUMSA) claimed that an additional R30 million was being routed by BAe via two Swedish trade unions to the South African National Civics Organisation (SANCO).⁻⁹⁵ It was alleged that these payments (bribes) would be dressed up as assistance to build an industrial training school, but their intended purpose was to secure political and trade union support for the arms deal. NUMSA's Denel shop stewards had already received gifts of Volvo and Saab cars and spent the 1998/1999 December/January holidays in England and Sweden on all-expense paid trips to study the "job creation benefits of the armaments industry". These allegations were confirmed by Swedish television and a London based organisation, Campaign Against Arms Trade. The British government were requested to investigate the payments as they allegedly originated in the UK. The then secretary of trade and industry, Stephan Byers, appointed the London Metropolitan Police to investigate the allegations. The eventual response was that it was not illegal under British law to bribe foreigners and, consequently there was no crime to investigate.⁻⁹⁶

The allegations of corruption in the South African Arms deal became public when certain concerned MP's briefed anti arms activist and founding member of the non-governmental organisation Economist Allied for Arms Reduction, Terry Crawford-Browne as well as Member of Parliament Patria De Lille. The MP's stated that they were disillusioned by what was happening in government and the fact that they had fought for liberation and freedom and not deceiving and robbing the peoples of South Africa by engaging in all forms of corruption.⁻⁹⁷

The MP's claimed that they were seriously concerned about the levels of corruption surrounding the arms deal and were in fact privy to information which confirmed that high level politicians were active participants in bribes and other illegal and illicit activities. They further claimed that Joe Modise saw the arms deal and other government contracts as an opportunity to replace the Oppenheimers as the new financial elite in South Africa. They believed that the arms deal was just the tip of the corruption iceberg that concerned oil deals, the taxi recapitalisation process, toll roads, drivers licence, the awarding of the communications and cellular licence to Cell C, the Coega development, diamond and drug smuggling, weapons trafficking, and money laundering. The common denominator, they added was kickbacks to certain government officials in return for political protection.

In their briefings made references to the dealings between the late Brett Kebble and high ranking government and influential officials.

A report by De Lille was handed over to Judge Willem Heath who headed the Heath Special Investigating Unit. Heath had particular powers assigned to him by President Nelson Mandela. Corruption around the apartheid –era homelands had been the original focus of his special mandate. Against a mandate signed by the president the Heath Unit could annul contracts found to be fraudulent and based on corruption. The unit was required to prove corruption on a balance of probabilities rather than beyond reasonable doubt. As a result of the allegations, and the report the Auditor-General (A-G), Shauket Fakie, launched a review of the arms deal. The A-G's subsequent report revealed a number of irregularities including conflicts of interest and self enrichment schemes surrounding the procurement process. The Standing Committee on Public Accounts (Scopa) received the report from the A-G and accordingly called the Department of Defence's head of acquisitions, Chippy Shaik to account.⁻⁹⁸ It is interesting to note that Chippy Shaik's brother is Schabir Shaik who was convicted of corruption relating to bribes elicited under the arms deal and was the personal financial adviser of former deputy president Jacob Zuma. Schabir Shaik was also the political guarantee for African Defence Systems (ADS), the company selected to install the electronics and weapons technology on the corvettes. Schabir Shaik's own company, Nkobi Holdings was given a 20% shareholding in ADS along with a company called Futuristic Business Solutions in which Joe Modise and Schabir Shaik were financial beneficiaries. During Shaik's trial the presiding officer, Justice Hilary Squires noted that the chief executive of Thomson CFS, another beneficiary company involved in the arms deal, Alain Thetard considered bribery and corruption as a standard practice in the arms trade.⁻⁹⁹

The former chair of the parliamentary defence committee ANC's Chief Whip Tony Yengeni was also convicted of fraud in that he lied to parliament regarding a discount he received on the acquisition of a Mercedes-Benz 4x4 from European Aeronautical Defence and Space Company (EADS) being a division of Daimler Chrysler, also a beneficiary company in the arms deal.

Without going into further detail, it has become abundantly clear in the wake of the allegations of corruption and the subsequent investigations that many high ranking politicians were beneficiaries of illicit payments and bribes by prospective and successful arms suppliers. There were of course attempts to detract investigations which was especially evident in the case of Judge Willem Heath. Heath came under huge pressure from the likes of Jacob Zuma and was berated by the President Thabo Mbeki himself over his investigations into the arms deal.⁻¹⁰⁰ On the 28 November 2000 the Constitutional Court ruled that a judge could not head a special Investigative Unit because it was unconstitutional for a member of the judiciary to head a special investigating unit.⁻¹⁰¹ Jacob Zuma vehemently opposed the subsequent report released by Scopa which reiterated that there were illicit dealings and corruption during the tender process. Judge Heath was subsequently relieved of his duties by President Thabo Mbeki. It is interesting to note that should Judge Heath have received a Presidential decree authorising his unit to investigate the arms deal, there would have existed a strong likelihood that the loan agreements entered into to finance the acquisition could have been declared null and void in that the preceding negotiations were tainted with corruption.

6.3 Finance

The Minister of Finance, Trevor Manuel was the signatory to the loan agreements entered into with various international banks and which was underwritten by the UK's ECGD. Despite claiming that the deals were concluded at highly favourable terms, it subsequently transpired that the agreements were anything but that. During an application by the ECAAR-SA in the Cape High Court to have the arms deal set aside, it was revealed that the agreements were highly onerous on the country especially in the event of default. It is argued that by signing the agreements, the Minister of Finance ceded control over South Africa's economic and financial policies to European banks and governments.

The purpose of the main loan agreement was to finance the Gripen fighter jets and Hawks and was entered into between the Barclays bank PLC, Her Britannic Majesty's Secretary of State acting by the Export Credits Guarantees Department (as Borrower) and the Republic of South Africa acting through its Department of Finance (as Lender).

In terms of the agreement, *inter alia*, the Minister of Finance guarantees that the claims of the Borrower will rank at least *pari passu* in priority in respect of external indebtedness, that no further encumbrances over present or future revenues or assets may be created without prior written consent of the Borrower, that exportable assets including gold may be attached, and that South Africa will remain a member in good standing, and eligible to use the resources of the International Monetary Fund (IMF).

The reliance on the IMF is especially alarming given the experiences of countries throughout Africa and South America that have financed armaments or other non-revenue producing acquisitions by means of foreign currency loans. It violates a fundamental principle of international banking that foreign currency borrowings must be repaid from resultant foreign currency income. If South Africa is unable to meet its financial obligations under the agreement, South Africa will be pressured to increase its borrowing first from commercial banks and then from the IMF until it becomes so indebted and financially enslaved that there exists the likelihood that South Africa can lose its sovereignty.

A further factor to consider is that the South African government is fully exposed to the depreciation of the rand against foreign currencies, which account for 75% of the total purchase amount. There is no effective means of hedging the currency risk inherent in the procurements. There is clearly a risk that the currency depreciation could be more rapid than anticipated, either on an ongoing basis or due to a sudden shock such as that precipitated by the 1998 Asian crisis. Any deviations from these assumptions are for the account of the government, with the obvious implication that the cost of the packages and their financing could be considerably higher than expected. The armaments procurements are distinguished from other government procurements by four key characteristics: The sums involved are extremely large, they involve fixed contractual obligations extending over long periods with high breakage costs, they are heavily import-biased, and their costs supposedly offset by a set of associated activities (NIP & DIP) which cannot be guaranteed. These characteristics create a set of important and unique risks for the government. The analysis of these risks suggests that as the expenditure level increases these risks escalate significantly.

It was on this premise that the governments own affordability team came to the conclusion that the government could be confronted by mounting economic, fiscal and financial difficulties at some future point. Ultimately the decision about expenditure levels really constitutes a decision about government's appetite for risk.

South Africa took delivery of its fifth corvette at Simon's Town on the 31 March 2006 and less than one month later, a Type 209 submarine, the SAS Manthatisi. The arrival of the vessels raised active debate around the questions of defence budgeting and where South Africa's spending trajectory is heading. With South Africa's current account deficit, at a 22 year high of over 4,2% of the Gross Domestic Product (GDP), the debates and questions raised around defence spending gain increasing significance as all arms deals are heavily import-content biased and impact directly of the balance of payments. It must however be noted that at present the current account deficit is being financed by investment inflows. At fiscal year ending 2006, the South African Reserve Bank pointed out that the arrival of a corvette as well as three aeroplanes under the arms deal in the fourth quarter of 2005 had, along with other factors, lifted the import value of the category for vehicles and transport equipment by about 20% in 2005 as a whole.

The questions and debates around defence spending occurs against the ever-present backdrop of South Africa's socio-economic priorities of poverty alleviation and the pressing need to materially alter the economic legacy of apartheid. The questions also arise against the broader institutional backdrop of defining the actual purpose and goals of the SANDF in the future in relation to its domestic as well as regional and international obligations/duties. The special defence account consumed on average 35,65% of the defence budget vote, primarily for the arms deal. South Africa will thus have to confront key questions concerning the overall defence strategy and posture of the SANDF. They will need to be matched with strategic answers that include the requisite resource-split between capital and current expenditure within the overall stretched defence budget in order to achieve all the goals set nationally, regionally, continent-wide, and globally, under the rubric of regional peacekeeping.

The original cost of the arms deal was estimated at R30 billion, this figure has now grown to an estimated R44,8 billion split over 12 years and does not take into account some of the opportunity costs associated with such an acquisition.

These opportunity costs are however now staring to show and reveal themselves by way of costs to integrate the new equipment into existing systems and structures as well as operational, maintenance and training costs.

In the case of the South African Air Force the costs of training personnel for the reception and integration of the Gripen and Hawk fighter aircraft into the air force will place added pressure on the overall budget.

Most of the initial candidate Gripen fighter pilots received their training in Sweden, the cost of which was borne by the South African government. The Air Force, as part of the package had to acquire simulators to train subsequent pilots in South Africa; the costs associated with setting up training facilities to house these simulators are enormous but, once again was paid for by the South Africans government. Similarly, the full integration of the corvettes and submarines will no doubt place pressure on the maritime combat capability budget sub-programme.

One of the most important factors to be considered by a receipt country when it comes to arms transfers is that fact that maintaining and keeping the newly acquired equipment operational is a costly affair and can have the effect of diverting valuable resources away from social upliftment projects and poverty alleviation. It is a documented fact that developing countries generally spend a greater proportion of their national product on arms than do rich countries. In recent years nearly half of the countries with the highest defence burden had low indicators of human development. An example of this is a country like Indonesia, who was the second highest recipient of international aid in 2004 but who spent almost the equivalent sum of money it received on aid on its military forces. Another good example of how opportunity costs impact negatively on a country's resources is that of Ghana, in 1999, the US government gave Ghana to insure patrol vessels to ensure that no other state was encroaching on Ghana's fishing waters – a legitimate justification that clearly seeks to support sustainable development and the livelihoods of Ghana's fishing communities. Although these boats were initially free, they are thought to be costing the Ghanaian Government about US\$1 million per annum in up-keep and maintenance, costs that were not discussed and assessed at the time of the transfer. It must be noted that in 1999 spending on the arms deal in South Africa has far exceeded spending on some other projects of the government like social grants, land restitutions and combating HIV/Aids to name but a few.

The agreements with the European banks which were underwritten by the ECGD are worth more than South Africa's debt obligations to the World Bank.

The government's treasury department stated in its budget review that the total loan redemptions for the fiscal year 2005/06 was R415 million more than anticipated, this mainly due to the net impact of prepayments related to the arms deal loan and a lower rand value of foreign loan redemptions due to a stronger rand.

It is also interesting to note that the treasury department has further indicated that an amount of US\$1 billion will be borrowed in the international market during the fiscal year 2006/07 to cover maturing foreign debt. The mitigating factors however is that at present the government's overall foreign denominated debt remains manageable at 13,4% of the GDP and the government has in recent times had great success in the collection of taxes by the South African Revenue Services (SARS) which resulted in an overall lower budget deficit and surplus funds available for government's coffers. It is also conceded that the strengthening of the rand in recent months resulted in clear savings in respect of the unhedged financing structures of the procurement. The contentious question still however remains, was it necessary for government to incur foreign denominated debt of the magnitude that it did for defence acquisitions? In addition the government's stated debt policy position is to emphasise further reductions in the cost of servicing debt in order to increase additional resources for economic development and poverty relief, which begs the question; why the decision to opt for the mix of priorities and goals that produced the arms deal itself and the scale of the subsequent procurement concluded?

Further questions must therefore also be raised about the macro-economic impact of the arms deal on the balance of payments given that South Africa has a near record current account deficit. It is conceded that the arms deal is not the only factor which has contributed to the current situation; other factors like the insatiable appetite of the South African consumers to acquire imported goods and the ever increasing price of Brent crude oil also contributed significantly to South Africa's negative balance of payments.

In addition, consideration must be given to the overall and long-term impact on the South African current account given the length of the procurement contract and taking into account additional factors like SAA's ongoing upgrade and acquisition of new Airbus aircraft and the planned acquisition by the South African government of eight new Airbus A400M transporter aircraft for the SAAF at a cost of R1 billion each (*which will be discussed in the next chapter*).

As mentioned above, the South African government placed a lot of its hope in the offset programmes and indeed placed reliance on these offset arrangements to cushion the impact of the purchases on the South African current account. Therefore in order to verify government's projected calculation regarding the benefits of the offset programmes one must measure claims of offset delivery against the broader backdrop of inflows (counter-trade-related direct investment and/or counter-trade-related project related exports) versus outflows (payment schedules for equipment and/or foreign debt maturation). The DTI, towards the end of 2005 briefed parliament's portfolio committee of trade and industry on National Industrial Participation programme performance. The DTI claimed that the overall NIP programme has generated R23 billion worth of investment and sales credits with programmes ranging from local manufacture of galleys for the Airbus A319 and A320 to the production of cockpit modules for the BMW 3-series for export purposes. The DTI claims further that the NIP has generated 8000 new work opportunities and 134 new projects- well short of the much more ambitious targets (as stated above). The task of monitoring the NIP obligations, which are supposed to be complete and due in 2013, (both defence and non-defence) falls on the DTI. It is submitted that this is a near impossible task given manpower pressures at the DTI and a myriad of policy challenges. Already three of the five main suppliers have missed their NIP scheduled obligations for offsets. NIP compliance is therefore appearing too much more of a headache and it is highly unlikely that the suppliers will meet all of their obligations as promised.

Chapter 7

Future of the South African Military Aerospace Industry

During the apartheid era in which the South African Aerospace industry was isolated (or supposed to have been), the South African government embarked on a programme to develop its own aircraft and weapons. Armscor, as mentioned above, was charged with providing the military with modern weapons. South Africa did not have a shortage of engineers and technicians and they were specifically mandated to respond to the challenge of the embargo and substitute local manufacture for imports. Despite isolation South Africa still managed to secure blueprints of existing aerospace and other military technology from certain countries who flaunted the United Nations Arms embargo. The South African engineers and technicians therefore became specialists in “recycled” technology. Their most significant feats and accomplishments relating to the military aerospace sector was the design and manufacture of the Cheetah fighter aircraft which were basically upgrades of the Mirage Fighters and which Israel assisted in developing and the Rooivalk attack helicopter which was derived from the French Puma helicopter. The Rooivalk was touted as the pride and joy of the South African military aerospace industry and boasted that it had virtually the same or similar capabilities as the American Apache attack helicopter. The Rooivalk project was however extremely capital intensive and cost the South African taxpayers billions over a period of almost twenty years. The challenge for Denel Aviation was to ensure a return on investment in respect of the Rooivalk. This challenge proved much more tedious and difficult and proposed deal after deal failed to produce a single international sale, the SAAF was the only purchaser and even this could not be really considered as a bona fide purchase considering the incestuous relationship between Denel and the SAAF. The closest that Denel came to selling one of the Rooivalks was in 2006 when it seemed as if Turkey would buy. However this was not to be. In early 2007, Denel announced that the Turkish deal had collapsed and that the Rooivalk project would now finally be abandoned.

Since the development of the Cheetah and the Rooivalk there have been no significant developments within the military aerospace industry and in this regard South Africa has had to take a backseat to Europe and the United States who have been primarily the only two global regions to develop and design new military aircraft.

South Africa has however had success in the manufacture and design of aviation components and has, to its credit been able to supply companies like Lockheed Martin and Airbus with modern, technologically advanced components. The arms deal of course has now given the South African Aerospace Military Industry a new lease of life. Through the Industrial Participation Programme, South African based companies have benefited somewhat from technology transfers orders for components of the aircraft that were procured through the arms deal. It therefore appears that the focus in the aerospace industry has shifted from that of design and development of entirely new aircraft to that of manufacture of components, systems (weapons and navigational) and systems for military as well as civilian aircraft.

The government's 1999 arms procurement deal was clearly not the end on governments spending spree when in April 2005 Cabinet ratified a "partnership agreement" concluded between the government and Airbus Industrie to purchase eight A400M airlift carriers (cargo transporters). To justify their purchase government argues that has an ever increasing African Union (AU) peace keeping mandate to fulfil and therefore requires the aircraft essentially for this purpose. The aircraft comes with a price tag of R1 billion each and delivery is expected in 2010. The financial obligations will begin to fall due in 2008, growing rapidly in 2009, just as the financial commitments for the current defence procurement programme begin to wind down. Notwithstanding government has already made an initial payment in respect of the purchases. It is predicted that this move by government will hasten the unbundling of Denel aerospace and land-systems conglomerate, forcing the divisions to forge new alliances with other South African high technology companies that have until now remained competitively aloof. The A400 is a new design aircraft and the catalyst to government's partnership agreement to acquire the aircraft is a multibillion-rand buy-in to a club of seven European countries to develop and manufacture this new-generation air transporter. In return for the eight aircraft purchased two important South African contracts have received guarantee design-and-build contracts worth about R3,2 billion, and expect further orders worth another R3 billion in the first 15 years of production. The European contraction partners include Germany, France, Spain, UK, Turkey, Belgium and Luxembourg. All of these countries have already ordered 180 of the aircraft, in addition to South Africa's eight.

The rationale and long term vision is that as new customers place orders for the aircraft and the customer base expands, the South African contractors and subcontractors will be assured a stream of work from this one programme, which is expected to remain operational for 50 years.

Denel Aviation and privately owned Aerosud are the prime South African suppliers to the A400M of such components as wing-to-wing to fuselage fairings and thermoplastic linings for the nose fuselage and cargo hold, products in which South African aerospace companies now excel in.

Things are however not as simple, in order to reap the long term benefits industry players and government will have to scramble to promote more niche technologies and ensure South Africa remains a global player in the highly lucrative market of aircraft systems, subsystems and lightweight composite materials. It is interesting to note that government did not open up the A400M contract for tender, and its abrupt announcement of the A400M deal drew sharp rebuke from many who rightfully questioned why the contract was not opened for tender, or pursued cheaper options. Also, an unexpected first payment of R763 million that government had to make in 2006 towards the A400M purchases, most of which came from annual defence spending has severely depleted the defence forces already strained operational capacity. Thus far there has been no evidence of corruption in the deal but the mere fact that government has chose not to open the contract for tender and keep the deal relatively secretive has raised a number of eyebrows. Some have argued that the government has deliberately kept the deal under wraps because of fears it would raise the political heat around Jacob Zuma.

Government as well as the contractors benefiting from the deal have however said that there is much to appreciate in the A400M partnership agreement: firstly it supposedly precludes South African offset liabilities in purchases, which it would normally have to endure if it had been an ordinary customer (as opposed to a development partner), and secondly the deal also, with regard to the financing of the subcontracts, claims to bridge the problem of South Africa's high cost of capital as compared to that of Europe and by requiring Airbus Military to pay South African contractors immediately upon receipt of payments from the South African government.

This obviates the need for the companies to make costly borrowings. The normal procedure would be for subcontractors to wait for the final sale of the aircraft before receiving payment. Government has also said that the A400M procurement/partnership dovetails with the DTI's efforts to promote aerospace, along with other high-value, advanced manufacturing sectors such as vehicles, diamond cutting, information and communications technology, pharmaceuticals and biotechnology, to make South Africa more globally competitive and able to retain valuable skills.

According to the DTI is estimated that the aerospace industry is expected to grow by 25% in real terms over the next 20 years to US\$250 billion per annum, and in relation to the civil aerospace industry, it is predicted that that the number of airlines will double to about 20 000 by 2020.



Chapter 8

Conclusion & Recommendation

With the deal being concluded delivery of the most of the armaments purchased under the arms deal having taken place, we can but only wait and see if such armaments will be put to good use at all. One of the reasons, besides the offset arrangements, why South Africa entered into the arms deal was the fact that South Africa was called upon by the international community to play an active role in peacekeeping mission both regionally and on the African continent as a whole. South Africa has played an active role as part of the African Union and United Nations efforts to bring about peace in certain troubled areas of the African continent. As mentioned above “peacekeeping” is carried out by the military which is a contradiction in itself as military personnel are trained warriors and not peacekeepers. Neither the African Union nor the United Nations has had the greatest of success in their peacekeeping efforts in areas like the troubled Dafur and the Democratic Republic of Congo. South Africa, as part of some of these missions has had a tarnished record with allegations of human rights abuses against the very people they were sent in to protect. It is submitted that one of the reasons why these missions are rarely a success is that the military personnel are not trained to be peacekeepers and also have inadequate and inappropriate equipment to enforce peace. This is due to the fact that Europeans and American arms companies and their governments have for decades sold military equipment to African States which is highly inappropriate and unnecessary.

The question therefore remains: how will the new fighter jets and warships assist in bringing peace and stability to the African continent? It is submitted that the equipment purchased in terms of the South African arms deal is highly inappropriate for use in peacekeeping missions. South Africa, it seems has bowed to pressure by Western governments to purchase inappropriate equipment for its defence force, and at a premium. South Africa failed to see that it was the very people who preached to rhetoric of peacekeeping, who sold the weapons to them. Any astute business person knows that in order to keep your business sustainable you need to provide your consumers with a good reason why they need your product, albeit inappropriate.

The very reason we need peacekeeping on the African continent is due to the fact that Western governments (and also the former Soviet Union) have for centuries stirred trouble and intervened in the affairs of countries on the African continent, from colonialism to plundering natural resources and then leaving these countries in the hands of military dictators. Nothing has really changed; Western governments continue to exercise economic control over many African countries in that most African countries are heavily indebted to these Western forces usually as a result of arms and weapons purchases. It is a fact that arms transfers impede development in developing countries and makes it more likely that countries will continue to engage in conflict rather than resolve them.

Notwithstanding, it is conceded that many African states are troubled and in turmoil and need properly trained peacekeepers to prevent further bloodshed. South Africa can indeed play a constructive role on the African continent both politically and practically in bring about peace, stability and democracy. As one of the most influential countries on the continent, South Africa, together with other truly democratic African states have the ability to exert sufficient political pressure on governments and other role players in effected countries to bring about change. From a practical point of view peacekeeping can be effective but only if peacekeepers are properly trained and have the necessary and appropriate equipment to carry out their mandate.

As noted above, one of the major determining factors why the South African government proceeded with the arms deal was the promise of offsets. Much has already been said about offsets and it is clear that recipient countries never receive the full value of the offsets that were promise. One needs to stand back at look at an arms transaction, including the promise of offsets holistically: Any arms transfer transaction is essentially a business transaction and not a charity event. The reason why people do business is for the acquisition of profit, why then would the South African government think that their deal was any different. There were many previous arms deals that were previously concluded between other countries and the very suppliers that South Africa was now dealing with, all promising lofty offsets. Research shows that not one of those deals every produced the offsets as promised. No astute arms trader is going to provide R110 billion worth of offsets against equipment sold for R30 billion, it just does not make any business sense. Why the South African government could not see this is quite incredible.

The South African government instead thought that they could outsmart the arms dealers by ensuring that they did not make the same mistakes as was made by other countries such as Turkey and Saudi Arabia who had concluded similar transactions. The South African government acknowledged the fact that the offsets in previous arms deals did not materialise and accordingly tried to build in “safeguards” to prevent the same happening to them. It subsequently transpired however that the South Africans did not even understand their own model of what they thought the offsets should be under the deal. Saab’s vice president was quoted as saying that “the South Africans do not understand their own model. There is a great intellectual problem.” Jayendra Naidoo, besides being part of the affordability team was also charged with the responsibility of trying to negotiate and maximise the offsets benefits after cabinet had approved the list of preferred bidders for the arms deal. It appears, with the greatest respect that Jayendra Naidoo was out of his depth trying to negotiate with a very strong delegation of Swedes and UK representatives who were no doubt “old hands” at mastering this type of negotiations.

It is submitted that South Africa’s focus was incorrect *ab initio*. Arms dealers came brandishing their goods in the one hand and the promise of offsets with the other. It appears that the South Africans were immediately smitten by the idea of offsets as a way to fast-track economic development in the country. It is submitted further that economic development cannot be fast-tracked by a programme of offsets. Economic development is a task that must be planned and driven by the government themselves and by no other parties. It is the responsibility of the government to create suitable economic and political conditions which will attract all forms of investments including foreign direct investments. Further, the government in terms of its economic plan should ensure that investments are directed into feasible and viable projects. As noted above the majority of the proposed offset investments were neither feasible nor viable. Already the DTI has reported that the some of the projects are behind schedule and that it is very likely that delivery of certain projects will not be fulfilled. The DTI has also been incapable to effectively monitor these projects and really mostly on the information given to them by the arms companies themselves regarding the progress of the projects. Arms companies and their supporting governments are well aware that it would be almost impossible to fulfil their obligations under offsets agreements would rather opt to pay a penalty under the offset contracts. In this regard it is more likely that arms companies would have built the penalty costs into the initial contract price thereby escaping liability completely.

It would virtually be impossible for an arms company to fulfil all of their offset obligations in respect of every deal that they conclude. A strategy employed by the arms companies would therefore be to initiate a project and if it proves not to be viable, simply abandon the project and opt to pay a penalty for non-compliance.

Another factor which militates against the use of offsets in arms acquisitions is that the promise of offsets encourages countries to purchase inappropriate weapons which are not geared toward those countries specific security needs. As mentioned above, South Africa viewed the offsets as the overriding factor in their arms acquisition programme notwithstanding the fact that they were presented with cheaper options regarding weapons choices but chose to ignore this and opted for the most expensive weapons. It is submitted that South Africa did not require the armaments which they acquired through the arms deal. Save for the Naval vessels, the current inventory of armaments of the SANDF would have been more than sufficient to last for at least ten to fifteen years into the future with regular maintenance and service. South Africa has unfortunately become another statistic of another developing country who have bowed to pressure from first-world arms suppliers and their governments to acquire inappropriate and expensive armaments and by so doing allowing ourselves (South Africa) to become heavily indebted to the West. South Africa was presented with a perfect opportunity to build itself up both socially and economically, to invest in its peoples and address issues such as Health care, HIV/Aids, education and the housing shortage. Instead our first order of business with our new found freedom and democracy was to purchase weapons, which in all likelihood will never see any combat, and will not add any substantial value to our country. It is quite incredible that the Department of Health has to cut down on the number of beds in tertiary hospitals such as Groote Schuur and Tygerberg hospitals in the Western Cape while we have brand new corvettes moored in Simon's Town naval harbour not adding any value to the millions of South Africans waiting in long lines at government hospitals and other institutions.

It is submitted that the root of the problem was essentially that of greed. A few high ranking politicians and officials saw the acquisition as a means for self enrichment and self gratification. The fact of the matter is that the entire procurement process was riddled with irregularities and corruption and even to this very day there have been renewed allegations of corruption emanating from the deal.

It is submitted that because the entire procurement process has been tainted with corruption, the deal itself cannot be justified on any grounds and the contracts should have accordingly been declared null and void. Since this was not the case one has to call to question the integrity of our politicians and leaders, knowing all the pitfalls, economic and otherwise, they simply chose to ignore the evidence and proceeded with the deal nonetheless. What is of concern is the fact that there appears to be too few leaders with integrity and strong character who are not afraid to say no to that which is wrong, albeit unpopular. To make matters worse there appears to be a disturbing trend, to prosecute those individuals who dare to stand up for what is right.

This has been clearly displayed in the arms deal processes and other events subsequent thereto. It is recommended that South Africans, especially those in leadership, should guard themselves against such behaviour. So even if our fellow comrades have fought alongside us for freedom, it does not give them the right to engage in illicit and illegal activity. Such behaviour goes against the very tenants of good governance, democracy and freedom and we have a duty and responsibility to expose and eradicate such elements without fear of favour.

The arms companies and their governments must not be allowed to continue their illicit practice of selling weapons and armaments to developing nations in the manner that they do. It is quite amazing that these companies are openly allowed to bribe politicians in order to secure a sale. More disturbing is the fact that many European supplier countries are acting in contravention of their own European Union Code on Arms Export which clearly states in criterion 8 thereof that a supplier country must take into account, inter alia, the economic resources of that the recipient country. At present, nothing is being done by the European Union to eradicate this type of behaviour by member countries and to call such countries to account. It is therefore submitted that notwithstanding the economic and political clout of some European countries, it is up to the prospective recipient country to ensure that they do bow to pressure and, consistently lobby the European Union to bring transgressors of the said code on Arms Exports to account.

Notwithstanding the foregoing, it is conceded that a country has the right to defend itself and be prepared for any eventuality. However, it is submitted that we must be prudent in our strategic thinking and planning when it comes to matters of national security. As mentioned above, South Africa is not facing any military threat and has sufficient equipment to reasonably defend itself against an external threat, albeit highly unlikely. It is however noted that South Africa does not currently have a “blue water naval fleet” as it once did. Does this however mean that we need to go out and purchase the most expensive naval frigates at this stage? One of the main reasons put forward by those who supported the arms deal was the fact that South Africa needs to protect its fishing stocks and therefore needs appropriate vessels to carry out this mandate. It is however highly questionable whether the vessels which were purchased are actually appropriate and suitable to carry out this task. It has been argued that there were more suitable vessels available and at a far lower cost. Regarding the Air Force, the currently fleet of Cheetah fighters were more than sufficient for South Africa’s needs and have by no means reached the end of their lifecycles it is therefore submitted that the acquisitions of the aircraft neither necessary nor appropriate.

In conclusion therefore, it appears that discipline of International Trade Law, in practice has worked against South Africa in this instance. As the deed is already done we can but only learn from this experience and ensure that we do not commit the same mistakes or allow our elected leaders to do the same again.

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