

**Bigger than the Sum of its Parts: Components and the Impact of a  
Responsible Arms Control Policy on the UK Economy**

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# **Bigger than the Sum of its Parts: Components and the Impact of a Responsible Arms Control Policy on the UK Economy**

**By Paul Dunne and Sam Perlo Freeman**

**Contents:**

**Executive Summary**

**0. Introduction**

**1. Arms Components**

**2. Arms Component Exports and the UK Government**

**3. UK Arms Control Policy and Component Exports**

**3.1 Direct exports of components vs. complete systems**

**3.2 Export of components for incorporation into complete systems**

**3.3 Licensed Production**

**4. Restructuring of the Arms Industry**

**5. Impact of Controls**

**6. Conclusions**

## Executive Summary

1. The UK Government is committed to an ‘ethical’, responsible arms trade policy that in practice has failed to live up to expectations.
2. There is some evidence that this has come about because of concerns, on the grounds of national security, to maintain a defence industrial base of some form through the encouragement of exports and the likely impact on jobs, industry and economy of export controls
3. Dunne and Perlo-Freeman (2002) found the imposition of a responsible arms control policy to have no serious economic implication, but did not deal fully with the important issues surrounding the important export of components.
4. This paper considers the issues involved in dealing with arms component exports. It surveys the present Government’s policy towards the exports of components for arms and finds evidence,
  - that a weaker standard of control is applied to the export of components and subsystems than to complete systems.
  - that the practice of licensed production could result in UK components and technology being included in weapons sold to countries to whom the UK would not directly export those complete weapons.
  - that less rigorous standards are applied to the export of components to a country for incorporation in equipment re-exported to a third country than for complete systems.
5. It is clear that the restructuring of the arms industry has important implications for the extent, importance and transparency of component exports and that a more restrictive policy on component exports would have no significant economic cost to the UK economy.
6. Policy recommendations include:
  - The International community need to establish international standards on the supply of arms, based on international humanitarian law and human rights, as contained in the draft Arms Trade Treaty, and to include components within the regulations.
  - At a national level the government should:
    - apply the Consolidation Criteria in a consistent manner with regards to components, not sacrificing these criteria to political expediency or narrow economic interests.
    - Clarify the meaning of the additional criteria for the export of components announced in 2002 and publish details of their use in the Annual Report on Strategic Export Controls.
    - Produce legislation controlling licensed production of arms and publish details of licensed arrangements approved in the Annual Report on Strategic Export Controls.

## 1. Introduction

In 1997 Robin Cook committed the UK Government to an ‘ethical’, responsible arms trade policy that went beyond any previous legislation. In practice, the policy has not had the impact that was hoped, with some recent arms deals seeming to betray the spirit of the legislation. There is some evidence that this has come about because of concerns, on the grounds of national security, to maintain a defence industrial base of some form through the encouragement of exports. Much of the discussion has related to the likely impact on jobs, industry and economy through the impact of export controls on the UK defence industry. This has become explicit in the new Defence Industrial Policy<sup>1</sup>, yet this is a terrain of considerable dispute, and it is not at all clear that the economy would suffer as a result of the imposition of a responsible arms policy.

Dunne and Perlo-Freeman (2002) considered these issues and found the imposition of a responsible arms control policy to have no serious economic implication. One concern in their analysis was the treatment of the export of components, both because of the possible problems in dealing with such exports within the context of the policy, and due to the increasing importance they are taking in the changing international arms market. Components complicate export controls, as they cover a wider range of goods than are considered ‘military’, and as there are many more companies involved in their production, many of whom would not consider themselves ‘defence companies’. As a result there is greater opportunity for fraudulent claims by exporters that they are being used for civilian purposes when they are not. There is also a clear problem around the internationalisation of the defence industry. There has been massive restructuring over the last 15 years, resulting in ever-greater co-operation between companies, with parts produced in one country being assembled in another. There is also an increase in the intra company export of components and subsystems within increasingly international companies. This creates problems regarding the boundaries of responsibility: to what extent should the Government consider the ultimate use to which a component is put, and the nature of the ultimate customer for the system of which it forms a part?

Europe has started to look at this problem within its own boundaries – a ‘Framework Agreement’ is being developed which involves the six largest defence manufacturers, looking at streamlining the licensing decision process. But no work has been done looking at cooperation outside the EU.

This paper considers the issues involved in dealing with arms component exports, using a definition of components that is fairly broad, as discussed in the next section. Government policy towards components is then outlined and the actions of Government with regards to the policy are considered, to gauge whether components have been treated differently to complete systems. In particular, the question asked is whether the legislation for components is less restrictive than that for complete systems in practise, considering direct exports of components, exports for integration into complete systems abroad, and licensed production. The implications of the restructuring of the arms industry for the extent, importance and transparency of component exports is then considered. Following the analysis of Dunne and Perlo

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<sup>1</sup> British Ministry of Defence, *Defence Industrial Policy*, Policy Paper no. 5 (Directorate General Corporate Communication: London, 2002),

Freeman (2002), an analysis of the impact of more stringent controls on component exports is then undertaken. Finally some conclusions are drawn and some policy recommendations made.

## 1. Arms Components

Defining a defence component is not straightforward as it can cover a whole range of products and this can make measurement very difficult, as the following taxonomy illustrates:

Complete weapon	Weapon component	Weapon spares
I	I	I
Dual use product	Dual use component	Dual use spare
I	I	I
Civil product	Civil component	Civil spares

It is easy to see complete weapons or systems as weapons and dual use products may be complete products that make up part of a weapon system (eg Range Rovers). There are also civil products that are components for weapons systems, across a range of technological sophistication (from computer systems to batteries and ball bearings). Within complex weapons systems there can also be weapons that are components of the systems, which are relatively easy to recognise (eg machine guns), but dual use components, such as ejector seats and overhead displays may be more difficult. Civil components, across a range of technical sophistication, from computer chips to ball bearings are much less visible. In addition, once weapons systems have been supplied there will be a demand for spares, maintenance and possibly training across the lifecycle of the weapon system. The spare will again range from the visible weapons, such as replacement machine guns, through dual use spares to civil spares, with again decreasing visibility. Spares in this report are treated as components, but there are some differences with components per se, as they will be demanded after previous sales of weapons systems to countries and refusing to provide specialist spares and support to a customer will likely impact very strongly on weapons sales to other countries.

This paper considers the issues involved in dealing with arms component exports, using a definition of components that is fairly broad. It includes subsystems, electronics, software, production equipment and technology, engines, etc... Basically anything that is not a weapons system, a weapons platform, a weapon, or ammunition.

## 2. Arms Component Exports and the UK Government

The UK's arms export control policy is governed by the Consolidated Criteria (combining previous UK criteria with the EU Code of Conduct)<sup>2</sup>, which has 8 clauses.

<sup>2</sup> These are listed as Appendix 1 to "The Export Control Bill", House of Commons Library Research Report 01/64, p.61, available at [www.parliament.uk/commons/lib/research/rp2001/rp01-064.pdf](http://www.parliament.uk/commons/lib/research/rp2001/rp01-064.pdf).

The government will not issue a licence if any of the first four apply, namely those relating to arms embargoes and weapons of mass destruction proliferation, human rights, armed conflict and regional stability; and will consider issues around the last four, namely UK national security, terrorism, diversion to undesirable end-users, and sustainable development. There is also a caveat category, 'Other Factors', which allows the government to 'take into account the effect of proposed exports on economic, social commercial and industrial interests, but that these factors will not affect the application of the criteria in the Code'.

As Dunne and Perlo Freeman (2002) argue, the Consolidated Criteria are, in principle, an extremely useful way of applying a moral dimension to arms controls, to try to ensure that arms do not get into the hands of those who would misuse them. However, this admirable position – whilst still remaining as official policy – does appear to be shifting. In practice, any potentially controversial licensing decision is always, in the last stages, a judgement call made by Ministers and there have been a number of extremely questionable decisions<sup>3</sup> It appears that the present Government is increasingly concerned about the impact on UK jobs and the UK defence industry as a whole, and is giving this more weight in licensing decisions, despite the fact that these 'Other Factors' are not supposed to affect the application of the Criteria.

As regards arms components, Jack Straw issued new guidance on export licensing decisions in July 2002, applying to the exports of components to be incorporated into a complete system, and then exported to third country. While the Consolidated Criteria on licensing decisions are still to be taken into account, five other factors will also be considered<sup>4</sup>. These new factors address issues such as national strategic interest, the significance of the exports etc:

- (a) the export control policies and effectiveness of the export control system of the incorporating country;
- (b) the importance of the UK's defence and security relationship with the incorporating country;
- (c) the materiality and significance of the UK-origin goods in relation to the goods into which they are to be incorporated, and in relation to any end-use of the finished products which might give rise to concern;
- (d) the ease with which the UK-origin goods, or significant parts of them, could be removed from the goods into which they are to be incorporated; and
- (e) the standing of the entity to which the goods are to be exported.

It would seem that these have been drawn up from the 'Other Factors' section of the Consolidated Criteria. They seem to have the effect of placing a narrow interpretation of the UK's defence and security interests above respect for the core principles of the Consolidated Criteria - sustainable development, human rights and regional stability.

At the same time that the new guidelines were announced, Jack Straw also announced a decision to allow the sale of British components (electronic Heads up Displays) to be incorporated into American F-16 fighter aircraft for onward sale to Israel. These planes have recently been used in raids on the Occupied Territories and there is clear

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<sup>3</sup> Air Traffic Control System to Tanzania, various exports to India and Pakistan when the situation in Kashmir was on the verge of all out war, F16 components for onward sale to Israel etc.

<sup>4</sup> See Appendix 1 for detail

evidence that they have been used against civilians<sup>5</sup>. In February this year, after it was revealed that British tanks were deployed by Israel in the Occupied Territories, the Foreign Secretary announced that the Government would no longer recognise assurances from Israel that British equipment would not be misused. Thus, in the current climate it is extremely doubtful that the Government would have licensed the sale of the components *directly* to Israel, yet it managed to justify the indirect sale via the USA.

This makes the new guidance extremely significant. It allows components to be assessed and licensed differently to whole systems, weakening the influence of the moral code enshrined in the Consolidated Criteria. Taking this to its logical conclusion, it means that by simply exporting arms equipment to another country first and not insisting on any UK Government control over the final destination, British arms could theoretically be exported to any country in the world.

The Government has argued that there is a need to introduce these new factors because there has been significant restructuring and realignment of the defence industry and cross-border production is becoming more commonplace. Whilst this is true, the export from the UK of components to be incorporated into weapons systems is not a new phenomenon, and certainly predates the adoption of the Consolidated Criteria. A quick look through the government's Annual Report on Strategic Export Controls reveals that components are a key defence export for the UK. Hence it is unclear why there is a special need for these new export criteria to be introduced now.

### **3. UK Arms Control Policy and Component Exports**

Dunne and Perlo-Freeman (2002) provide an analysis of the results of the Government's export control policy. To get some idea as to whether the government operates, in theory and in practice, a *different* policy with respect to the export of components and sub-systems of weapons and weapons systems, than to the complete weapons and systems themselves, we analyse Hansard and recent Annual Reports on Strategic Export controls. This breaks down into three sub-questions. First, whether the government applies less rigorous standards to the export of components to a country for its own use than to exports of complete systems to the same country. Second, whether the government applies less rigorous standards to the export of components for incorporation in equipment re-exported to a third country, than to direct exports to that third country<sup>6</sup>. Third, how the Government deals with licensed production.

#### **3.1 Direct exports of components vs. complete systems**

In principle exports of components are subject to the same controls and criteria as complete weapons systems. They are included in the Military List of controlled goods, and are subject to the Government's Consolidated Criteria for arms exports. Furthermore there are examples where the government has expressed specific concern regarding the use or potential use of UK-supplied components. For example, the UK Government received an assurance from the Israeli Government on 29<sup>th</sup> November

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<sup>5</sup> e.g. "Israeli operations timeline", BBC News online, [http://news.bbc.co.uk/2/hi/middle\\_east/1860497.stm](http://news.bbc.co.uk/2/hi/middle_east/1860497.stm)

<sup>6</sup> as in the case of Israel outlined above

2000 that “No UK originated equipment *nor any UK originated systems/subsystems/components* are used as part of the Israeli Defence Force’s activities in the Territories.” (our italics)<sup>7</sup>

Foreign Office Minister Ben Bradshaw stated:

“We have no evidence that equipment or components manufactured in the UK and licensed for export by this Government have been used by Israeli forces against civilians in the occupied territories during the recent and continuing violence. We would be concerned if such evidence came to light.”<sup>8</sup>

When evidence did in fact come to light that previously exported Centurion tanks had been modified into APCs by Israel and used in the territories, this was specifically reported to both houses of parliament.

There are, however, a number of instances where Government actions do suggest that a different policy operates in relation to component exports. The clearest example is the case of China, which is subject to a partial EU Arms Embargo, though this is interpreted differently by the individual EU members. A memo<sup>9</sup> dated 26/2/2002 to the Quadrapartite Committee examining the 2000 Annual Report from the FCO, DTI, MoD and DfID states that the UK interprets the embargo as including:

“Lethal weapons such as machine guns, large calibre weapons, bombs, torpedoes, rockets and missiles”, “Specially designed components of the above and ammunition” “Military aircraft and helicopters, vessels of war, armoured fighting vehicles and other such weapons platforms” and “Any equipment which might be used for internal repression”. In addition, “All defence exports to China are assessed on a case by case basis against the Consolidated EU and national arms export licensing criteria.”

Thus, while components of ‘lethal weapons’ are banned, components of weapons platforms are not. Indeed, the 2001 Annual Report on Strategic Export Controls lists a number of components, technology, software and related systems for weapons platforms licensed for export to China that year. These include a considerable number of categories of equipment that would clearly be for use in or with a weapons platform which would itself be subject to embargo<sup>10</sup>. A second example is the EU embargoes against countries intervening in the conflict in the Democratic Republic of Congo (DRC), Angola, Burundi, Rwanda, Uganda and Zimbabwe. (There is now a full UK embargo against Zimbabwe relating to other issues). The terms of this embargo state:

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<sup>7</sup> <http://www.parliament.the-stationery-office.co.uk/pa/cm200102/cmselect/cmcaff/718/718ap10.htm>

<sup>8</sup> Parliamentary Answer on 14/11/2001

<sup>9</sup> <http://www.parliament.the-stationery-office.co.uk/pa/cm200102/cmselect/cmdfence/718/718ap07.htm>

<sup>10</sup> Aircraft military communications equipment, components for airborne radar, components for aircraft military communications equipment, components for aircraft radar, components for combat aircraft simulators, components for destroyers, components for military aero-engines, components for military infrared/thermal imaging equipment, components for military sonar detection equipment, general military vehicle components, military aero engines, software for the use of military aircraft navigation equipment, technology for the use of combat aircraft simulators, technology for the use of military aero-engines (temporary), test equipment for military aircraft navigation equipment.



"The Government will not grant export licenses for new military equipment to countries intervening in the Democratic Republic of Congo (Angola, Burundi, Rwanda, Uganda, Zimbabwe) if there is a clear risk that it would be used in the Democratic Republic of Congo. *Applications for Standard Individual Export Licenses to provide spares for UK equipment already supplied under pre-existing contracts will be examined on a case by case basis against our national criteria and the EU Code of Conduct on Arms Exports.* In reaching decisions on such applications, the government will take into account the wider implications of forcing UK companies to break existing obligations." (2001 Annual Report, our italics)

Clearly, spares for previously licensed equipment are treated differently from new equipment, including all complete weapons systems and platforms. In fact, the 2001 Annual Report shows no examples of licenses issued to any of these countries that could have been allowed on account of these criteria. However, a very similar argument was given by the government in 2000, that refusal to supply spares would create an impression of UK companies as unreliable suppliers, to justify the licensing of Hawk spares to Zimbabwe. Thus, this difference is not purely hypothetical.

In addition to differing criteria on embargoes, there are at least two other ways in which components in practice may be subject to looser criteria. Firstly, the use to which components are put is more difficult to monitor. The UK does not systematically monitor end-use of equipment arguing that it is too late to do anything by then and that the emphasis should be put on the licensing. They do, however, suggest that their representative overseas are expected to report allegations of misuse so that these can be taken into account in considering future licences<sup>11</sup>.

On 25<sup>th</sup> March 2001, Trade & Industry Secretary Stephen Byers was questioned by the Defence Select Committee. Asked about end-use monitoring, and a hypothetical example where combat weapons were licensed and then used against civilians, Mr Byers replied:

"I think there is little that can be done in that particular example [of UK licensed weapons used against civilians]. What we would clearly do is if there are further licenses that we need to consider [for similar weapons to the same country] then those activities would be taken into account in determining our decision in relation to those licenses."

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<sup>11</sup> . Nigel Griffiths, speaking for the government on 9<sup>th</sup> July 2001 defended this:

"Sadly, that is the best example of shutting the stable door after the horse has bolted. End-use or follow-up monitoring can confirm misuse or illegal diversion only after they have taken place, when it offers minimal opportunity for effective action."

Similarly, in a Supplementary Memorandum responding to follow-up questions from the Quadrapartite Committee relating to the Foreign Secretary's oral evidence of 21<sup>st</sup> March 2002, the Foreign and Commonwealth Office argues that:

"The surest way to prevent UK arms ending up in the wrong hands is to examine export licenses carefully at the licensing stage and to refuse an export license when there is an unacceptable risk of diversion or misuse... specific commitments to Post export monitoring are rare."

However, the same memo also says:

"All our overseas posts have standing instructions to report on any allegations of misuse of UK-origin defence equipment *so that it can be taken into account in the licensing process.*" (our italics)

This implies that if UK weapons platforms and systems used against civilians or for aggressive action against neighbours, similar equipment would not be licensed in the future. However, the government admits that dealing with components will be rather more difficult. They recognise that the abuse of components is much less likely to be detected than abuse of complete systems, and therefore the future licensing of components is much less likely to be blocked<sup>12</sup>.

This may not relate just to abuse of previously supplied British equipment. In response to the Foreign Affairs Select Committee's March 2001 report, the Foreign and Commonwealth Office (FCO) stated

“We have not issued any licenses for equipment or for components of equipment which, at the time of assessment in line with the Consolidated Criteria, had been used aggressively against Palestinian targets”.<sup>13</sup> However in the case of components, it would not be possible to be certain whether they were used for the equipment intended.

The second way in which components may in practice face an easier licensing regime is in relation to issues related to regional stability and balance of forces. The problem relates to the case-by-case nature of decisions on Single Individual Export Licences (SIELs), and what the cumulative effect of a large number of component licenses might be. A memorandum from the FCO answering written questions from the Quadrapartite Committee<sup>14</sup>, points out that the consolidated EU and national arms export criteria set out the issues to be taken into account in reaching licensing decisions. In this the cumulative effects of the purchase of arms by the recipient countries may well be a relevant consideration, but decisions on individual applications must be made on a case by case basis against the criteria. The FCO also suggests that cumulative effect is a consideration, but is not specific when pressed on whether export license for components would be blocked because of the overall level of arms supplies to that country by the UK, rather than the individual characteristics of the equipment under consideration.

The most pressing example of this and where the government came in for some of the strongest criticism from the Foreign Affairs Select Committee, is that of India and Pakistan. These countries came close to war in 2002 and licences for a large number of component licenses, but no complete systems, were granted.<sup>15</sup>

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<sup>12</sup> A letter from the FCO to the Foreign Affairs Select Committee<sup>12</sup> on 21 March 2002, regarding the modification of UK Centurion tanks licensed by a previous government into APCs for use in the West Bank, notes:

“We have received no evidence that equipment manufactured in the UK and licensed for export by this government has been used by Israeli forces in the Occupied territories since ... September 2000. *Many UK exports have been for components for pieces of technology, which can be embedded in other systems and are therefore not visible.*” (our italics)

<sup>13</sup> <http://www.parliament.the-stationery-office.co.uk/pa/cm200102/cmselect/cmtrdind/718/718ap07.htm>

<sup>14</sup> Relating to the Foreign Secretary's verbal evidence on 21/3/2002. See <http://www.parliament.the-stationery-office.co.uk/pa/cm200102/cmselect/cmcaff/718/718ap11.htm>

<sup>15</sup> The Committee's 2002 Report on the Government's Annual Report for 2000 concluded:

“... if the situation in India and Pakistan in the spring of this year did not fully engage Criterion Four [relating to international aggression], it is difficult to conceive of circumstances short of all out war which would do so... The stand-off over Kashmir should in our view have led to its application with very great rigour... we are concerned that in recent months there is little real evidence of the terms of the Criterion being applied in proportion to the rise in regional tension.”

Examples of licenses to India issued in 2001 include components for airborne radars, airborne targeting equipment, aircraft cannons, aircraft head-up-displays, aircraft military communications equipment, aircraft radars, combat aircraft, combat helicopters, components for destroyers, frigates, military aero-engines, military aircraft navigation equipment, military engineer vehicles, military transport aircraft, naval sonar equipment and tanks. Other licenses include those for aircraft military communications equipment, castings for naval engines, equipment for the development of military aero-engines, equipment for the use of combat aircraft, forgings for combat aircraft, forgings for military aero engines, forgings for naval engines, military aircraft communications equipment, production equipment for combat aircraft, technology for the production of frigates, technology for the use of combat aircraft, unfinished products for large calibre artillery ammunition and unfinished products for torpedoes (Annual Report 2001). Licenses to Pakistan include components for: Combat aircraft, combat helicopters, frigates, large calibre artillery, military aero engines, mine hunters and naval engines. Also equipment for naval radars, naval sonars, submarines, surface to air missile launching and torpedoes.

While detailed information for 2002 does not yet exist, the Foreign Affairs Select Committee report on the 2000 Annual Report<sup>16</sup>, indicates that between December 2001 and April 2002, 101 SIELS relating to military aircraft were issued to India, and 30 to Pakistan. In the two months up to 10<sup>th</sup> June, the Foreign Secretary told the house that a total of 140 SIELs had been issued for India and 15 for Pakistan.

This does suggest that actual combat aircraft, frigates, tanks, destroyers, submarines and torpedoes may have been subject to much greater scrutiny and would most likely not have been licensed. While at some stage cumulative effects of licenses may have been taken into account, there is no evidence that this ever led to a cessation of licenses even during the periods of highest tension between the two countries.

There is also evidence to suggest that components are considered politically easier to license than complete systems. Licenses issued to Israel in 2001 include components for bombs, combat aircraft, armoured fighting vehicles and combat helicopters. Without knowing exactly which systems they were intended for, or whether those specific systems had previously been used against Palestinian targets, it is hard to see how one could have any degree of confidence that the weapons into which they were incorporated would not be so used. Likewise, aircraft components licenses to Indonesia raise cause for concern, given the Indonesian military's activities in West Papua and Aceh. Politically, however, they create less problems than, say, Hawk jets. It is worth noting that in a parliamentary answer on 14 December 2000 replying to a question on arms sales to Indonesia, Foreign Office Minister Peter Hain noted that the majority of licenses issued in 1999 were for components, and that there were no main equipment sales. This suggests that the Minister saw the distinction between components and main equipment as being, at least, politically relevant.

Overall, there does appear to be evidence, both in terms of official policy statements and actual licensing practice, that a weaker standard of control is applied to the export of components and subsystems than to complete systems.

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<http://www.parliament.the-stationery-office.co.uk/pa/cm200102/cmselect/cmffaff/718/71809.htm>

<sup>16</sup> <http://www.parliament.the-stationery-office.co.uk/pa/cm200102/cmselect/cmffaff/718/71805.htm>

### 3.2 Export of components for incorporation into complete systems

The issue that caused the most controversy in 2002 was the export of components for incorporation into a complete system, which may then be re exported to a third country. The government has explicitly confirmed that it will apply different standards to such exports than to direct exports to the third country. As we have seen, head-up-displays (HUDs) were licensed to be sold to the US for incorporation into F16s sold to Israel. This was despite the fact that F16s have been used in attacks by Israel against Palestinian targets. According to the statements given in the previous section, components for F16s would not have been sold directly to Israel. This represented a change in policy by the government, the reason given being that not to license the HUDs would jeopardise the UK's defence relationship with the US and the UK's defence industrial base. It is likely that the government was concerned for Britain's participation in projects such as the Joint Strike Fighter (JSF). The Government's position was set out in detail in a Parliamentary Answer by Foreign Secretary Jack Straw, described in Section 2. Also see Appendix 1.

The Foreign Affairs Select Committee in its Eighth Report<sup>17</sup> made a number of comments regarding this policy. They concluded that criteria (c) and (d) above suggested that "the more insignificant a component is to the finished product, the more likely it is to be approved for export, while at the same time the more significant a component is to a finished product, the more likely it is to be approved for export", and sought clarification. They also asked for a number of other clarifications:

- Whether it was only the UK's defence relationship with the incorporating country that was relevant, or also the UK's DIB and commercial relationship with that country.
- What the relevance is of the export control regime of the incorporating country, and the status of the entity receiving the goods.
- Whether the new criteria meant that licenses would be issued that otherwise breached the Consolidated EU and National Criteria.

They also suggested that the Government's Annual Report for 2002 should state which licenses these new criteria were decisive for.

The issue of incorporation of components into goods for onward export is also central to the 6-Nation Framework Agreement which the UK government entered into in 2000 along with France, Germany, Sweden, Italy and Spain, relating to collaborative weapons programmes. The purpose of this Agreement is to facilitate the exchange of information, technology and equipment for collaborative defence programmes, and to co-ordinate R&D and export policies with respect to such programmes. This was the subject of a Defence Select Committee report produced on February 14<sup>th</sup> 2001<sup>18</sup>. This suggested that there are two key factors. First, that exports of components for use in agreed programmes are to be made easier as they will be subject to Global Projects Licenses, which mean that the usual procedure of seeking SIELs or OIELs is not necessary. Second, that a secret 'white list' of approved export destinations for

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<sup>17</sup> [www.parliament.the-stationery-office.co.uk/pa/cm200102/cmselect/cmcaff/718/71803.htm](http://www.parliament.the-stationery-office.co.uk/pa/cm200102/cmselect/cmcaff/718/71803.htm)

<sup>18</sup> <http://www.parliament.the-stationery-office.co.uk/pa/cm200001/cmselect/cmdfence/115/11502.htm>

finished products was to be created. Countries on this white list will be specific marketing targets and while the UK is unlikely to refuse export licenses of main equipment to the other five countries, the final export destination of the finished products is still an issue. The existence of Global Project Licenses will of course facilitate such exports, but it is not clear what process will be used to agree a 'white list' for each programme. Nor is it clear, at this stage, whether this will mean in practice a loosening of UK controls, a tightening, or no change. In principle, the white list is drawn up by consensus, so that any country involved in a particular programme can veto the inclusion of a particular destination. In addition, as all countries are members of the EU, the EU Code of Conduct would apply alongside national criteria. The Agreement stipulates that a country can only be removed from the white list if there is a major change in their circumstances, for example the outbreak of civil war, but where one of the countries in a programme asks for a country to be removed from the white list, it will be out of bounds for exports until consensus is reached. Given that Sweden, for example, has rather tight export controls, this could mean that UK components would be less likely to be exported to sensitive third country destinations via incorporation in a system produced in another country. However, countries involved in programmes, might be under considerable political pressure not to block destinations to which the other countries wished to export, especially if their share of the programme is low. An MoD official, questioned by the Defence Select Committee and quoted in the Report, admitted that if a minor partner was too eager to wield its veto of particular destinations,

“...they are unlikely to be a partner of choice in future collaborations. They will also have ... to take into account ... bilateral relations with the countries concerned, as well as the industrial coalitions.”

Overall, it is now the government's clearly stated position and practice that , at least in some cases, controls on components incorporated into complete systems are less stringent than controls on complete system exports, though the precise parameters of this policy are far from clear from the criteria issued by the government in this regard. It is also unclear at this stage whether the Framework Agreement would lead to a increase or decrease in the national export controls of the six countries involved.

### **3.3 Licensed Production**

Licensed production is another case where UK components may be incorporated into complete systems in a second country for export to a third. The difference with the first two cases is that the second country will usually be at a more dependant technological level than the UK, rather than a higher level as is the case with the US, or a similar level as with the Framework Agreement.

There are no specific controls on licensed production of arms in UK law, and the Government explicitly resisted incorporation of such controls in the Export Control Bill. Past licensed production agreements, for example involving Heckler & Koch, have certainly led to export of arms designed by UK-owned companies to countries to whom the UK would not directly export, and indeed Oxfam have detailed such cases<sup>19</sup>. A case in point is the production under license by MKEK of Turkey of

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<sup>19</sup> “Small arms, wrong hands, A case for Government control of the small arms trade”, Oxfam GB Policy Paper, April 1998.

Heckler & Koch infantry rifles, agreed in 1998, under the current government. While there is no evidence that these have been sold to destinations that would be refused by the UK government if it were a direct export, MKEK did sell 500 MP3 sub-machine guns to Indonesia in 1999, produced under a previous license from H&K<sup>20</sup>.

The Government claim that they already have sufficient power to control licensed production and that the Export Control Bill will strengthen this. Responding to an amendment that would establish specific controls, Nigel Griffiths, the Minister in charge of the bill made a short statement suggesting that a license will usually be required for the initial supply of technology and equipment (including electronic supply of technology), that the possible misuse of the finished product or export to an unacceptable destination will prevent a license being issued. In addition, if after a licensed production programme has been established the equipment is misused or exported to an unacceptable destination production could be obstructed by refusing licenses for ongoing supply of components<sup>21</sup>. Lord Sainsbury of Turville also told the Lords on 7/2/2002 that the Government took into account whether components and technology were intended for licensed production, and that they were seeking EU-wide agreement to add explicit reference to licensed production in the EU Code of Conduct.

There are, however, a number of reasons why this may not be as comprehensive a control as might be desired. The components supplied may all be of a civilian nature, but used for incorporation in a military product. This was the case with Otokar in Turkey, who started producing a Land Rover with a machine gun mount in 1994, using 80% components from the UK, all of which were classified as civilian<sup>22</sup>. The Minister's statement says only that it is 'likely' that production could be hamstrung by a refusal to supply further components. It is not impossible to imagine that, once

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<sup>20</sup> E.g. Campaign Against Arms Trade briefing on Licensed Production, <http://www.caat.org.uk/research/LicensedProduction.pdf>.

<sup>21</sup> "In short, the Government consider the amendment unnecessary because the Bill already gives us effective powers. It provides for significant control over the practical means by which licensed production arrangements are established and maintained. Such arrangements typically depend on the company in the UK that licenses the manufacture of its products supplying component parts or production technologies to the overseas producer. Where the product is manufactured under licence and has a potential military end use, an export licence will, in most cases, be required before the equipment and technology necessary for the establishment and further operation of the licensed production facility can be supplied.

The Bill provides a new power to control technology transfers, whatever the means involved. That will close a loophole in the export control regime, whereby a licence would not be required to transfer military technology if the transfer took place by fax or e-mail.

Where, in the case of potential military end use, essential components are needed to ensure that licensed production overseas can be maintained, a licence will be required for updating, for building the facility and for supplying the components. We have made it clear in discussions on licensed production overseas that a licence will not be granted for the supply of controlled goods or technologies that are needed for an overseas manufacturing facility where there is a clear risk that the finished products could be used for internal repression or external aggression or where there is an unacceptable risk of diversion to an end user.

The Bill will strengthen and make more comprehensive the UK's capacity to control the supply lines on which licensed production arrangements depend. The important issue is that we are introducing measures to effectively and practically control licensed production overseas. We are likely to be able to hamstring it effectively by refusing licences if there have been substantiated reports of previous diversion or illegal use. I therefore urge the Committee to reject the new clause." (18/10/2001

<sup>22</sup> Campaign Against Arms Trade briefing on Licensed Production, <http://www.caat.org.uk/research/LicensedProduction.pdf>.

technology has been transferred and production started, necessary components could be sourced from elsewhere in the event of UK refusal. New components can be refused, but technology cannot be easily untransferred.

Without specific controls on licensed production agreements, the transfer of components and technology for licensed production is very difficult to scrutinise. For example, it is not possible to tell in the Annual Report which licenses might relate to licensed production, let alone where the finished products may be exported. Of course it is not known exactly what any given set of components is going towards, but licensed production adds a further layer of non-transparency<sup>23</sup>. With regard to direct exports, the Annual Report enables the reader to assess, at least in part, how well the government has followed the Consolidated Criteria. Where licensed production is involved, such detailed scrutiny is more or less impossible.

It is further worth noting that on 14/3/2001, in answer to a PQ about the Rayo MRL system, manufactured in Chile under license from Royal Ordnance, the Minister responsible, Dr. Kim Howells, stated that “The DTI has no records of any discussion with either British Aerospace/Royal Ordnance or the Chilean authorities about the export or re-export of Rayo rocket systems”. This suggests that the Government have not been as assiduous as the previously quoted answers suggest in assessing the risks of export to sensitive destinations.

Overall, there is some evidence that, despite the Government’s claim that there is already sufficient control of licensed production, the practice could result in UK components and technology being included in weapons sold to countries to whom the UK would not directly export those complete weapons.

### **Restructuring of the Arms Industry**

The Cold War defence industry was very clearly historically specific and very different to what had gone before it. It was very much a modernist industry with its clusters of inventions and technocratic culture. It was also a consciously planned product of the nation states, who wished to have the capability to produce and develop a comprehensive range of weapons, to create a national Defence Industrial Base (DIB) (Lovering, 1998). In this way it was the product of particular structure of national and international relations, markets and technologies underpinned by a superpower arms race. It should be no surprise that the end of the Cold War saw such profound changes.

With the end of the Cold War there was a huge decline in the demand for arms. The resulting restructuring has left world arms production highly concentrated. In 1996 the 10 largest arms producing countries account for almost 90% of production: sales, about \$200 billion (not including China and Russia). This declining trend has stopped, though restructuring continues in the USA and the EU. In the USA concentration peaked in 1998 when 4 huge arms companies absorbed more than 20 others. Further concentration has been blocked by anti trust concerns and some problems with the

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<sup>23</sup> This point is illustrated by a lengthy parliamentary exchange between Ann Clwyd and Nigel Griffiths on 13 June 2002, where Ms Clwyd tried to establish what sort of licenses had been issued to one country with other countries as the end-user, with little meaningful result. A relatively large amount of investigation would seem to be needed to uncover a rather small amount of useful information.

integration of the different companies. Western Europe seems to be heading towards cross border integration but cross-Atlantic links remain important (Skoens and Weidacher, 1999).

This rationalisation in response to declining demand saw no real conversion to civil production and the internationalisation has not created the truly global companies expected. What is clear is that the old 'spin off' of technology, as the benefits of military technology for civil industry were called, is no longer important. Instead 'spin in', the increasing use of civil technology and products in military good has become prevalent. This means there is an increase in the amount of civil components and subsystems that can be used in weapons systems.

The major defence companies have also changed. They have moved away from being manufacturing companies over a range of products to become systems integrators, putting the products of other contractors together. In this way subcontracting has become increasingly important for the defence contractors, as they outsource. This has also led to more non-traditional companies being involved in work for defence companies. It is also clear that the supply chains have extended internationally. This is nowhere clearer than in British Aerospace's moves into South Africa (Batchelor and Dunne, 1999). There have also been numerous cross border equity swaps and purchases, the development of joint ventures, licensed production, technology transfer, which are clearly a strategy of internationalisation by the companies. These developments by the companies were well ahead of the national governments' willingness to allow control over their national DIB to wane. (Skoens and Weidacher, 1999).

This has led to networks developing across the world and makes the existence of a comprehensive production capability within any country other than the US an impossibility, and even in the case of the US unlikely. The companies have not globalised, however, in the sense of becoming transnational and losing their home base. They remain tied to their national bases, requiring the support of national governments as major customers. National orders are still important in getting export orders and arms companies get considerable support from the government in exports.

With the cuts in procurement, trade became increasingly important to the companies and they pushed to achieve exports. At the same time the subcontracting and creation of networks has led to an increase in trade within companies and within their networks. The international companies can buy components and sub systems from another member of the group, based in another country. This clearly has an impact on transparency and makes domestic government control extremely difficult.

### **Impact of Controls**

Dunne and Perlo-Freeman (2002) provide a detailed analysis of the destination of arms exports. Taking the Government's Annual Report on Strategic Export Controls and using the information on the total value of Single Individual Export Licenses



(SIELs) approved to each country the countries were divided into three categories High, Intermediate and Low sensitivity<sup>24</sup>.

The total value of SIELs were:

	Using SIELs		Using actual exports
High Sensitivity,	£527m	27.5%	19.1%
Intermediate Sensitivity	£581.5m	30.4%	9.8%
Low Sensitivity	£806m	42.1%	71.0%

% are percentage of total

The figures are reported for the total value of SIELs, together with the values of actual exports of equipment, given in the Annual Report. These figures differ as not all arms export licenses go through SIELs, many go through Open Individual Export Licenses or Open General Export Licenses. As these are likely to be to less sensitive destinations, these figures would tend to overstate the proportion of sales going to highly Sensitive destinations, and understate that going to low ones. Using the figures for actual exports of equipment in 2001, gave quite different proportions, with a lower proportion of exports to the more sensitive destinations. These figures are based on EU Tariff codes, however, and do not include all items on the military list. In particular, items such as military communications, software etc., that is, equipment that wouldn't be so readily classed as a weapon or part thereof, are not included. It is therefore possible that the more sensitive destinations tended to get more of this less sensitive type of equipment, and that therefore these figures understate the proportion of exports going to the more sensitive destinations. As the figures for SIELs probably overstate the picture for the High Sensitivity countries, as they would be less likely to get OIELs, the true picture probably lies somewhere between the two.

The Defence Manufacturers Association of Great Britain, in their Memorandum to the Defence Select Committee of 25 November 1999<sup>25</sup>, argue that "The UK especially demonstrates great strength in the high technology sub-systems sphere, where it has a particularly strong record in most sectors. In consequence, a considerable proportion of defence export contracts won each year have been for subsystems, components, spares etc. and there are very few major Western high technology programmes which do not have some level of British subcontractor participation."

This suggests that the effects of, say, excluding the High Sensitivity countries could be a lot higher than suggested by the figures quoted. If the policy were extended to components incorporated into main equipment and then re-exported (as logically it should be), a very high proportion of UK arms exports could be impacted, both directly through refused licenses, and indirectly through other Western producers with weaker controls seeking alternative suppliers. It is however still unlikely that the reduction in arms exports would be more than 60%

Dunne and Perlo-Freeman (2002) analyses the effects of a stronger export control policy by the UK on the arms industry, by considering what would happen if the exports to highly sensitive destinations and the high and intermediately sensitive destinations were removed. Removing high sensitivity exports would mean reducing

<sup>24</sup> Countries where the total value of SIELs was recorded as 'less than £250,000' were excluded.

<sup>25</sup> [www.parliament.the-stationery-office.co.uk/pa/cm199899/cmselect/cmfaif/100/100ap30.htm](http://www.parliament.the-stationery-office.co.uk/pa/cm199899/cmselect/cmfaif/100/100ap30.htm)

arms exports by around 27.5%; adding the intermediate category suggests a reduction of 58%, but this would represent a maximum. When we take into account the possible exports of components it makes sense to consider the maximum figure. A study by Chalmers et al (2002) on the likely impact of a 50% across-the-board reduction of arms exports on the UK economy, concludes that the economic costs of reducing defence exports are relatively small and largely one off. The above analysis suggests that even the most stringent export control policy considered would lead to a reduction of arms exports not much greater than this, even if we take account of component exports. A policy of excluding just the most sensitive destinations (which also tend to be the cause of most political difficulty for the government), would lead to a reduction of only half that considered by Chalmers et al. This suggests that the imposition of such a policy would have no impact on the economy.

There is some concern that the impact of such a change may be catastrophic for the defence industry, but there are reasons why this should not be a concern on economic grounds. Firstly, the change in technology means that increasingly components and subsystems may have a high content of civil inputs, which are increasingly produced by a supply chain of companies that is not wholly dependent on defence, and so can move into other areas of production easily. There is also the issue that the arms industry is in decline and is declining in importance in manufacturing and the economy as a whole (Dunne and Perlo-Freeman, 2002). This still suggests that there will be a marginal impact on the economy as a whole. This is not to minimise the economic impact on individuals and communities where any adjustments fall most heavily, but government policy can provide assistance to change to new areas of economic activity. Such an action could indeed lead to benefits for the UK economy (Dunne, 1996). We are brought back to the conclusion of Chalmers et al (2002) that the defence industry has to be justified by recourse to non-economic concerns.

## *Conclusions*

This paper has considered the issues involved in dealing with arms component exports. It has surveyed the present Government's policy towards the exports of components for arms and analysed the actions of Government with regards to the policy, asking whether components have been treated differently to complete systems. An analysis of government practise in the case of direct exports of components, exports for integration into complete systems abroad and licensed production are considered. The study finds that:

- There does appear to be evidence, both in terms of official policy statements and actual licensing practice to specific countries, that a weaker standard of control is applied to the export of components and subsystems than to complete systems.
- It is now a matter of stated government policy and practice that controls on components incorporated into complete systems are less stringent than controls on complete system exports. However it is unclear at this stage whether the Framework Agreement on collaborative armaments projects would lead to an increase or decrease in the national export controls of the six countries involved.
- There is some evidence that, despite the Government's claim that there is already sufficient control of licensed production, the practice could result in UK

components and technology being included in weapons sold to countries to whom the UK would not directly export those complete weapons.

Thus, there is evidence that the Government does apply less rigorous standards to the export of components to a country for its own use than to exports of complete systems to the same country, and less rigorous standards to the export of components for incorporation in equipment re-exported to a third country, than to direct exports to that third country.

It is clear that the restructuring of the arms industry has important implications for the extent, importance and transparency of component exports. This makes it difficult for governments to monitor the transfers, both nationally and internationally and implies that there is the need for some form of international agreement and body to oversee. It is clearly important for the government to seek a more harmonised export control policy between major Western producers, especially the EU and the US.

It is also clear, however, that if a more restrictive policy on component exports was imposed there would be no significant economic cost to the UK economy.

## **7. Policy Recommendations**

Mephram and Eavis (2002) provide a detailed list of proposals that are consistent with the analysis of this report. We would emphasise:

- The increasing internationalisation of the arms industry and the growth in the importance of less visible components means there is a need for international control. There is a need for international agencies to establish international standards on the supply of arms, based on international humanitarian law and human rights, as contained in the draft Arms Trade Treaty, and to include components within the regulations.
- At a national level the government should
  - Apply the Consolidation Criteria in a consistent manner with regards to components, not sacrificing these criteria to political expediency or narrow economic interests.
  - Clarify the meaning of the additional criteria for the export of components announced in 2002 and publish details of their use in the Annual Report on Strategic Export Controls.
  - Produce legislation controlling licensed production of arms and publish details of licensed arrangements approved in the Annual Report on Strategic Export Controls.

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## Appendix 1

### New Guidance - 8 July 2002 – House of Commons

#### Export Licences

**Paddy Tipping:** To ask the Secretary of State for Foreign and Commonwealth Affairs how the Government considers applications for export licences for the supply of military equipment for incorporation into final products for possible onward export; and if he will make a statement. [67534]

**Mr. Straw:** In recent years there have been far reaching changes in the defence industry in the United Kingdom, the rest of Europe and the United States. Against the background of the end of the Cold War and the resulting reduction in defence budgets world wide, the defence industry has been subject to massive rationalisation. One consequence of this change is that increasingly defence goods are manufactured from components sourced in several different countries.

This restructuring of the defence industry presents new challenges for the Government's approach to export licensing. Many export licence applications are for goods which are to be incorporated in defence equipment in a second country, which thereafter may be exported to a third country.

The Consolidated EU and National Arms Export Licensing Criteria set out in a statement by my right hon. Friend the Member for Neath (Mr. Hain), *Official Report*, column 199–203W on 26 October 2000, make clear that they "will not be applied mechanistically" to decisions on export licence applications, but rather "on a case-by-case basis, using judgment and common sense". The criteria do not provide specific guidance on what approach should be adopted in these "incorporation" cases.

Other EU and NATO member states face the same rapidly changing environment for their defence industries as the UK. Enquiries by Her Majesty's Government suggest, however, that while as yet there is no common policy in such cases, many of our European partners recognise the need to adopt a special approach towards cases involving incorporation for onward export.

After very careful consideration, Her Majesty's Government has, therefore, decided that it is necessary to set out how it will in future approach licence applications for goods where it is understood that the goods are to be incorporated into products for onward export. The Government will continue to assess such applications on a case by case basis against the Consolidated Criteria, while at the same time having regard to, inter alia, the following factors:

- (a) the export control policies and effectiveness of the export control system of the incorporating country;
- (b) the importance of the UK's defence and security relationship with the incorporating country;
- (c) the materiality and significance of the UK-origin goods in relation to the goods into which they are to be incorporated, and in relation to any end-use of the finished products which might give rise to concern;
- (d) the ease with which the UK-origin goods, or significant parts of them, could be removed from the goods into which they are to be incorporated; and
- (e) the standing of the entity to which the goods are to be exported.

Against this background the Government has considered its response to a number of applications for the export of parts, subsystems and components to the USA for incorporation into equipment eventually destined for other countries. These include Head Up Display units (HUDs) for incorporation in F-16 aircraft scheduled for delivery to Israel in 2003. The UK content in F-16s is less than 1 per cent. in value, but the supply of HUDs is part of a long-standing collaboration in this US programme. Any interruption to the supply of these components would have serious implications for the UK's defence relations with the United States.

The Government continues to be seriously concerned about the situation in Israel and the Occupied Territories. There has to be a break to the cycle of violence, which has brought so much misery to both

peoples, and a resumption of the peace process. We are working closely with partners including the US to reduce the level of tension and to bring about a sustainable and peaceful settlement through negotiation.

The United States Government maintains a strong and effective export licensing system. The Quadripartite Committee has noted that the United States' conventional arms transfer policy "does not appear to differ in any important way from the EU Code or the UK national criteria. In some respects . . . it is an improvement" (HC 467 xxix 73 (25 July 2000)). Appropriate use of arms exported to Israel by the US is the subject of regular dialogue between the two countries, and when the US have concerns they make these known to the Israelis (as required by Congressional legislation). The State Department has been monitoring Israeli actions carefully and will continue to do so.

At the same time the Government carefully takes into account the importance of maintaining a strong and dynamic defence relationship with the US. This relationship is fundamental to the UK's national security as well as to our ability to play a strong and effective role in the world. The importance of this role has been demonstrated repeatedly in recent months. There are also wider benefits to the UK's national security of maintaining a strong indigenous defence industrial capability.

Taking account of all these considerations, the Government considered that the applications should be approved, and my right hon. Friend the Secretary of State for Trade and Industry has today granted licences for the export of the HUDs, and other equipment to the USA. The Government will apply similar considerations to similar applications in future.

Also see the QSC report – First joint report of session 2001-2002, published 19 July 2002.  
Strategic Export Controls: Annual report for 2000, Licensing Policy and Prior Parliamentary Scrutiny  
Available from the Parliament Website