

Publication: ECAAR Issued: Date: 2003-12-18 Reporter: Terry Crawford Browne

## **ECAAR-SA Files Amending Papers Ahead of Arms Deal Court Case on 17 February**

**Press Statement by :**

**Economist Allied for Arms Reduction - South Africa**

**18 December 2003**

Economists Allied For Arms Reduction--South Africa (ECAAR-SA) has yesterday filed amending papers for our application that the loan agreements which give effect to the arms deal should be ruled unconstitutional, and thus declared to be null and void. The purpose of our litigation is to collapse the arms deal. Heads of arguments will be filed about 27 January 2004 ahead of the court hearing on 17 February 2004. In summary:

1. We contest that Ms Maria Ramos, as former Director General of the National Treasury and thus a civil servant rather than a politician, is even competent to respond on behalf of the President, the government or the Minister of Finance. We submit that her affidavits, as the government's defence, should therefore be struck out.
2. It is evident that there is neither parliamentary nor administrative authority for the arms deal, which is therefore illegal as well as unconstitutional. The Defence Review considered by Parliament in April 1998, on which the government relies, specifically declares that it "does not constitute blanket approval" and "at best it constitutes approval in principal"..."subject to available finances."

3. The arms deal was predicated upon economic assumptions that expenditure of R30 billion on warships and warplanes would generate R110 billion in offsets to create 64 165 jobs. Offsets are internationally discredited as being an invitation to malpractices, a reputation substantiated by the Joint Investigation Team report which found that every contract was flawed with tendering irregularities, and thus failed the constitutional tests of Section 217 regarding government procurements.

4. The conclusions and recommendations of "the documents containing the advice of the International Offers Negotiating Team and the Financial Working Group" awarded by the Cape High Court to ECAAR-SA in March 2003 (but finally received on 17 November 2003 after our application that the President, government and the Minister of Finance be declared to be in contempt-of-court) state, quote:

### **5.1 Conclusions : Unique characteristics of package procurements**

5.1.1 In fiscal, financial and economic terms, the armaments procurements are distinguished from other government procurements by a number of factors. First, they are very large. No other procurement decision that the SAG has ever made -- or is ever likely to make -- involves anything like the aggregate sums under discussion in this case, even on the more limited expenditure levels. Expenditures of this order will inevitably involve both a move away from government's existing fiscal targets and a significant restructuring of the national budget towards defence expenditure.

5.1.2 Second, the procurements will entail fixed, contractual commitments extending over a number of years, with high breakage costs. If economic conditions worsen, government's ability to readjust military expenditure in order to respond

accordingly will be constrained by the costs attendant on contract cancellation.

5.1.3 Third, they are heavily import biased. Unlike most other procurements, the armaments packages involve the accumulation of extensive liabilities in hard currencies -- and the forex exposure contingent upon these -- in order to fund what is essentially a large order of imported equipment.

5.1.4 Fourth, the costs of the procurements are largely mitigated by a set of associated activities (the offset investments) which cannot be guaranteed. Put differently, the benefits related to the acquisitions are not nearly as certain as their costs.

### **Risk assessment**

5.1.5 These characteristics imply a set of significant and unique risks for government. The analysis given in sections 3 and 4 is intended to capture the potential implications of the most important of these. Two sorts of "intrinsic" risk -- related to interest rate movements and under-performance in respect of NIP -- have been captured as part of the economic and financial modelling exercise.

5.1.6 It is important to note that a probability factor has not been attached to these risk scenarios. It is not possible to specify with any degree of certainty that there is, say, a 50 or 60 percent chance of any of these scenarios materialising either fully or to some limited extent. However, these scenarios have been defined and chosen because there is some identifiable prospect of conditions tending in this direction. The reasons for this are discussed in detail in section 3.5 of the document. In the case of the risk of NIP under-performance, they relate essentially to the possibility that the NIP performance guarantees -- the only mechanism available to compel NIP performance -- have been built into the contract price, mixed experience on NIP performance in other countries, and the

views of the independent international experts on the steel projects actually offered by the suppliers. In the case of the interest rate increases, the factors relate mainly to the centrality of government's positive record on its fiscal targets in establishing credibility in loan and international markets, and the potential impact of a significant and sustained breach of these targets to fund non-productive expenditure.

5.1.7 An assessment of these dynamics will clearly be an important part of the Ministerial decision-making process. It should not be forgotten here that in addition to the "intrinsic risks" which are assessed and discussed above, a number of "extrinsic" risks -- such as those of Rand:Dollar depreciation, worsening economic conditions and so on -- could create conditions which are significantly worse than those described in scenarios as modelled.

5.1.8 The most fundamental point that emerges from the risk analysis is that as expenditure increases, the risks of the procurements escalate significantly. In fact, even the R16.5 billion expenditure scenario involves significant risks. Relative to a situation where no arms were purchased, under the "combined adverse scenario", by 2008 GDP would be 1.6 percent (R16bn) less, the budget deficit would be 0.8% higher, there would be 115 000 fewer jobs, government would be spending 2.5% more of its revenues on debt service, and the total public sector debt stock would be 5 percent higher.

5.1.9 In sum, the chief value of the risk analysis lies in its demonstration that to the extent that conditions do develop adversely government will be confronted by mounting difficulties. These difficulties grow as the expenditure level rises. Ultimately, then, the decision about how much to spend on the arms packages really constitutes a decision about government's appetite for risk.

## **5.2 Recommendations**

5.2.1 The AT has refrained from recommending any specific procurement scenario to the Ministers' Committee. The purpose of the analysis presented above is to demonstrate the potential impacts and implications of different expenditure levels. It is for Ministers to choose which level is appropriate.

5.2.2 Notwithstanding, the AT does have certain recommendations to make:

Ministers should decide on an expenditure ceiling and leave the negotiation of a specific procurement combination to the Lead Negotiator and the Department of Defence to finalise, subject to final Ministerial ratification. There are two chief reasons for this. First, a wide variety and combination of equipment purchases is possible at any expenditure level. Deciding on the best possible combination will require a detailed exploration and negotiation of various options. Second, the DoD should have a particularly strong voice in this decision: it is, after all, the DoD budget which is funding these acquisitions and the Department is best placed to decide on the optimum combination of Defence equipment at any given expenditure level. The presence of the Lead Negotiator will allow the non-defence aspects of the procurements to be taken sufficiently into account, and the Ministers will need to take the final decision at political level. Notwithstanding, simultaneous with the expenditure ceiling decision, the Ministers' Committee should decide on the basic question of whether to purchase both Hawk and Gripen at this point and, in particular, whether the "tranche option" offered by BAe should be accepted. This because of the magnitude of the Gripen expenditure is particularly large and because the structure of the tranche option potentially involves significant and peculiar costs for government as a whole. The character, announcement, timing and "packing" of the procurement decision will be of utmost importance in determining reaction to it across a wide variety of fronts: local and international markets;

various local constituencies and interest groups; foreign governments, and so on. The Lead Negotiator should be charged with developing a strategy for this announcement in consultation with bodies such as GCIS as a matter of urgency. unquote

Given the unambiguous warnings contained in the study, it is evident that the Ministers' Committee and Cabinet simply "did not apply their minds" when they approved the arms deal in December 1999. It is not surprising that the government has gone to extreme lengths in its efforts to prevent disclosure of these documents to the South African public. These efforts have included inducing collusion of ECAAR-SA's first legal team to "throw the case". The Minister of Finance, in particular, recklessly disregarded the constitutional responsibilities of public office when he signed the foreign loan agreements in January 2000. It is his signature which gives effect to the arms deal.

It is also noteworthy that although the arms deal was presented to the public as a unique opportunity for economic stimulation and job creation, even the best case scenario estimates a loss of 115 000 jobs in the economy because of this non-productive expenditure.

5. ECAAR-SA obtained over the internet the British-South African government loan agreements that cover the purchase of BAe Hawk and BAe/SAAB Gripen fighter aircraft. Government's senior counsel conceded in court in March 2003 that these documents are authentic. He referred the court to the representation, covenant and default clauses, and then attempted to intimidate the court by warnings of the severe consequences that cancellation of the arms deal would entail. Not only does ECAAR-SA note that the Constitution is the supreme law of the Republic of South Africa, but we also insist that the courts are not permitted to abdicate their responsibilities when cabinet ministers act irrationally.

The Minister of Finance was alerted on many occasions, as well as by the affordability study, to the risks of the arms deal, and also that allegations of corruption were then being investigated by the Heath Special Investigating Unit. As made clear in the representation, covenant and default clauses of the loan agreements, he has ceded control over South Africa's economic and financial policies to European banks and governments and the International Monetary Fund.

6. ECAAR-SA participated in the Defence Review in Parliament during 1996 to 1998, both in its own capacity and as representative of the Anglican Church. With other non-governmental organisations and even the 1996 Defence White Paper itself, we argued then that poverty is the major threat facing South Africa's transition to democracy and that expenditure on armaments must necessarily be deferred. Regrettably, the crises of poverty facing South Africa have not been redressed during the past ten years, and the excuses for non-delivery have run dry.

Shacks blight our cities, and that situation is worsening rather than improving. The shacks in the Western Cape could all be replaced with houses for the cost of three submarines. The department of housing estimates that every R3 billion spent on low cost housing creates 88 000 jobs in the building and building supply industries. The rate of unemployment is approximately 42%. HIV/AIDS is forecast to result in the deaths of six million South Africans by the year 2010, a casualty rate inconceivable even in a worst-case war scenario. Yet the Minister of Heath declared a year ago that there was no money for AIDS because South Africa must buy submarines for protection against invasion by the United States! Issues of human security -- jobs, housing, education, health services, crime prevention, the environment etc. -- are prioritised by the South African Constitution.

ECAAR is an international non-governmental organisation, with affiliates in thirteen countries including South Africa, whose board of trustees includes eight Nobel laureates. ECAAR's purpose is to promote objective economic analysis and appropriate action on global issues relating to peace security and the world economy so that conflicts between states can be managed without resort to war. Archbishop Njongonkulu Ndungane and Ms Rhoda Kadalie are patrons of ECAAR-SA

It is evident that the arms deal was driven by the European armaments industry and governments. Germany would win the warship contracts. Britain and Sweden would win the warplane contracts, and Italy would supply helicopters. These were government-to-government transactions in disregard of the EU Code of Conduct on Arms Exports, and in which the needs of South Africans were deemed irrelevant.

ECAAR-SA has led the opposition by civil society to the arms deal because of the socio-economic consequences of the arms deal, and South Africa's constitutional commitments to social upliftment. This litigation has been undertaken as a matter of last resort in the public interest and in terms of Section 38 of the Constitution. IDASA has described the arms deal as "the litmus test of South Africa's commitment to democracy and good governance". At stake is calling government to account to the Constitution and to the people. We are confident that the Cape High Court on 17 February 2004 will set aside the loan agreements, and will thus collapse the arms deal.

*Terry Crawford-Browne*

[http://www.armsdeal-vpo.co.za/special\\_items/statements/ecaar\\_emending.html](http://www.armsdeal-vpo.co.za/special_items/statements/ecaar_emending.html)