

## THE ARMS DEAL CONTROVERSY

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The South African arms deal, or Strategic Defence Package (SDP), has been mired in controversy virtually since its inception. More than three years after signature of the contracts in December 1999, there are still aftershocks caused by various parties hoping to either stop the process or at least inflict serious political damage. This seems to stem from being aggrieved at being excluded from the deals, because they have never subscribed to the need for such expensive equipment for the SANDF or are concerned that a fair process was not followed.

The bundle of projects that was handled as a single package to obtain maximum commercial and political leverage constitutes the largest armaments deal ever concluded in South Africa. It consists of 28 Gripen Advanced Light Fighter Aircraft and 24 Hawk Lead In Fighter Trainers from BAE/SAAB, 4 corvettes from a German Frigate Consortium, 3 submarines from a German Submarine Consortium, and 30 Agusta 109 helicopters from Italy. The total contract value at date of signature was approximately R24.9 billion (US\$3.98 billion) at the rate of exchange prevailing at that time (R6.25 to the US dollar and R6.4 to the euro). The bulk of the equipment is to be imported and the value of the contracts fluctuates as the rand fluctuates against the other currencies.

Reaction against the deal stems from five separate concerns that tend to get intertwined:

- Does South Africa need such a large and well-equipped defence force?
- Can the country afford the costs of the project?
- Do South Africans know what the true cost of the project is (as the number seems to vary every time the government puts a value to it)?
- Given that there are accusations of improper behaviour by various officials, such as Tony Yengeni, was the deal compromised, or was there a fair process in place during the negotiations and signing of contracts?
- Was there corruption and is it being dealt with, or is there a cover up?

Let us consider these issues in some detail.

After 1994, the newly elected democratic government set about revisiting all aspects of national life with a view to transformation appropriate to the new open democratic order that they wished to build. Like other branches of government, the Ministry of Defence initiated an open consultative process to establish a consensus about the future nature of the South African National Defence Force (SANDF). This Defence Review process is unprecedented internationally for its openness and willingness to engage with the widest possible range of opinion. All and any interested parties were invited to participate. It culminated in a Defence White Paper in 1996, the Defence Review Report in 1998, and a White

Paper on Defence Related Industries in 1999. Each of these passed through the parliamentary portfolio committee before final approval by Cabinet. The process covered a range of issues affecting the roles, structure, size and shape of the Ministry of Defence and the SANDF. It defined 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. To achieve territorial defence the first requirement is deterrence, necessitating the maintenance of a credible defence force. While support to the police would be phased out, the role of regional peacekeeping was added.

It was acknowledged that there was no immediate military threat to South Africa, but that 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. Four different force design options were studied and presented to the South African Parliament and Cabinet for final decision. It seems fair to say that South Africa engaged in the most open process of anywhere in the world, in the design of its military establishment. Naturally there was a range of opinion on what was needed, but it is somewhat disappointing that having followed this consultative path, the South African government should continue to be criticised for the choices made.

The force design was planned to require 1.8% of Gross Domestic Product (GDP) to pay for acquisition of armaments as well as operating costs. This compares favourably to other countries in the region, such as Nigeria, which also accepts a role in peacekeeping, with 4.5% of GDP, and smaller neighbours such as Namibia with 6.3% and Botswana with 4.5%. In the final days of apartheid military spending was as high as 4% even after the end of the Angolan conflict. Thus, purely as a percentage of GDP, the budgeted level is well within international norms. In addition the quantities of the various systems procured under the SDP, and forming a part of the core force design, were adjusted to remain within

budget during the tendering process. The planned versus final quantities appear in the table below:

<i>Equipment</i>	<i>Planned</i>	<i>Actual</i>
Gripen	38	28
Hawk	24	24
Corvettes	5	4
Submarines	4	3
Helicopters	60	30

The defence budget is currently running at 1.62% of GDP, well short of the levels accepted in the Defence Review.

Furthermore the Government imposed industrial participation (IP) obligations to offset the effects of such a major outflow of money, to the extent that the contractors have accepted industrial participation obligations of 407% of the contract value, or R102 billion (US\$16.2 billion). The value of the IP obligation is expressed in the same currency as the purchase contract, and will fluctuate as the rand weakens or strengthens. This means that the contractors will generate economic activity consisting of exports, investments and technology transfer, generating credits equivalent to four times the contract value in hard currency. These obligations are to be met over a seven-year period (11 for Gripen which has a longer production schedule). By their nature, most of the investments will endure beyond the fulfilment period of the contracts and continue to give benefit. The IP contracts are being managed with the same diligence as the purchase agreements, and only suitable projects generating appropriate and sustainable economic activity are accepted. This economic activity will go a long way to mitigating the affordability argument. However because such investment is not immediately visible to the general public it appears to have been frequently overlooked.

It is often questioned whether the government really knows what the package will cost. The short answer is that in foreign currency terms there have been no surprises, but given the volatility of the rand, the value in Rand terms varies from day to day. Budget rules require that values of commitments only be

revised annually, and then with the rand values and escalation parameters available at budget time. No other forward projection can be made. This often leads to confusion as reported project costs vary from year to year. On the other hand the offset obligations are also set in foreign currency terms. Thus variations in the value of the IP projects will offset variations in project cost.

Concerns about irregularities in the decision-making process have been raised by various parties, including a report by the Auditor General to the Select Committee on Public Accounts (SCOPA) in September 2000. In its report to Parliament, SCOPA recommended that four bodies, the Public Protector, the Auditor-General, the Directorate Special Operations of the National Prosecuting Authority, and the Heath Special Investigations Unit be instructed to undertake a comprehensive forensic investigation of all aspects of the SDP. The South African government declined to appoint the Heath unit despite much acrimony. Although it is unprecedented that the other three agencies co-operate on a single investigation, and all three have distinguished themselves over the last three years in fearlessly rooting out irregularities and corruption in various other areas of government, the exclusion of the Heath unit seems to have cast a shadow of doubt over the work of the other three agencies. This is truly unfortunate, as the Joint Report submitted to Parliament in November 2001 reflects a thorough investigation of all the issues.

The investigators reviewed approximately 700,000 pages of documentation and interviewed numerous witnesses, including people who had raised specific complaints and accusations. Drawing on all the resources of the three agencies, as well as contracting in external auditors, the resulting report gives an impression of professionalism, objectivity, and insight. The conclusions can be summarised as follows:

#### *Procurement policy*

Prior to 1994, Armscor had been the sole procurement authority in the Ministry of Defence. Procedures were set up to handle procurement mainly from local industry, where usually only

one firm had the specific skills and capabilities that had been carefully nurtured. By the time the 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, and henceforward tenders were to be open, with international participation encouraged. Substantial and robust approval procedures had been put in place to manage large projects like the SDP, ensuring participation of the arm of service requiring the equipment, the SANDF headquarters, the Secretariat of Defence, Armscor, the Minister and Deputy Minister of Defence, and the Cabinet. Various bodies were established ensuring participation by all relevant parties at each stage of the project, from requirement definition, to project study, to formal Requests for Information and short listing, to calling for tenders, to evaluation, and finally approval of the choice of equipment. The SDP also required substantial industrial participation, as well as financing, and therefore the Department of Trade and Industry and the Department of Finance were involved in evaluating these aspects. At no stage was a decision taken by a single person. Project teams or committees took all decisions. All decisions were reviewed at higher levels, and final decisions on the main issues were taken by Cabinet.

#### *Systems choices*

All but one of the projects had clear winners in terms of performance, price, IP and financing. In fact most were price and performance competitive before considering IP or financing, both of which weighed heavily in the evaluation of projects. The exception was the Lead In Fighter Trainer. After extensive evaluation the British Hawk and Italian Aermacchi MB 339 were the final two from which a choice had to be made on this project. Although the Hawk was twice as expensive as the MB339, and offers only limited improvement in performance, British Aerospace Systems (BAE) offered US\$1.2 billion in IP benefits compared to US\$431 million from Aermacchi. Ultimately the Cabinet accepted the BAE offer, taking a strategic view of the improved IP benefits and the enhanced opportunities for South African industry inherent in the relationships that this

would bring. Healthy debate preceded this decision and the final decision was taken by Cabinet, effectively ruling out the possibility that a single individual could have taken this decision.

### *Biased decision-making*

The weapons system on the corvettes has drawn a fair amount of attention, because the then Chief of Acquisitions at the Secretariat for Defence, Chippy Shaik, appears to have had a conflict of interest, as his brother is a shareholder in ADS, the company appointed to integrate the weapons system and because another local company that had quoted to supply the data bus for the system has stated that it was unfairly treated when the data bus was awarded to ADS. This matter was also investigated and the joint report draws some clear conclusions. In terms of procurement policy, Armscor does not contract to the sub-contractor level, leaving the prime contractor responsible for the total product in terms of technical, cost, and timescale performance. For strategic reasons such as desired local content, Armscor may list preferred contractors, but it is the prime contractor's responsibility to assess the designated company from a performance and risk point of view. Thus Armscor nominated ADS, a South African company, as the preferred supplier for the weapons system, based on the considerable investment the Navy had made over several years in establishing the required technology at ADS and the development of various key sub-systems by ADS. In fact tenderers were required from the outset to enter a teaming arrangement with ADS as the nominated supplier. ADS in fact became a member of the German Frigate Consortium (GFC) during the bidding process. This occurred long before Mr Shaik became involved with ADS (his involvement only occurred after the French company Thales acquired ADS). It is almost certain that ADS would have been the weapon system supplier, whether Mr Shaik was involved or not. Incidentally, similar investments were made in ADS for submarine weapon system technology, but ADS is not a party in the submarine project.

The weapons system consists of guns, missiles, radars, sonars, optical tracking devices, mostly made by local companies, plus com-

puters and software, and a variety of consoles made by ADS, allowing members of the combat team to acquire targets, track targets, and deploy weapons either for attack or self defence. All these elements are connected via a data bus. The other company, C<sup>2</sup>I<sup>2</sup>, had been nominated as supplier of the data bus based on technology investments made by the Navy. Given the centrality of the data bus and the technical risks in integrating it into a large number of sub-systems, the GFC thought the risk of using the C<sup>2</sup>I<sup>2</sup> data bus was too great. The joint report details the complex bargaining process that followed and culminated in the selection of a Thales data bus from ADS. Although the Joint Project Team (JPT) was involved throughout in evaluating both the C<sup>2</sup>I<sup>2</sup> and Thales systems, and it appears that the JPT expressed a technical preference for C<sup>2</sup>I<sup>2</sup>, it appears inevitable that the Thales system would be selected because the GFC as prime contractor had the final say in terms of risk. The project team also found the Thales data bus was perfectly adequate, and the price difference between R49 million for Thales and R 37.8 million for C<sup>2</sup>I<sup>2</sup> was negligible within the context of a R2.6 billion weapons suite, especially if non-performance could compromise the whole system.

### *Corruption allegations*

Finally, on the subject of possible corruption, the report indicates that instances were identified of improper and possibly criminal conduct, and that these were being followed up by the Directorate Special Operations of the National Prosecuting Authority, as criminal activity is not best prosecuted in public reports. "Whilst there may have been individuals and institutions who used or attempted to use their positions improperly...to obtain undue benefits in relation to these packages, up until now no evidence has emerged to suggest that these activities affected the selection of the successful contractors/bidders, which may render the contracts questionable. As matters stand, there are presently no grounds to suggest that the Government's contract position is flawed." The only reservation one may have is that so little has emerged in the courts more than a year after the Joint Report.

From the above it is clear that the whole SDP process was conducted in the full light of public scrutiny. The process of defining the operational requirements, inviting suitable tenderers, and selecting the winning bidders/products was transparent and participative to a degree not seen before in South Africa, or most other places. There may have been individuals who could not resist the temptation to benefit from the deal by pretending to have more clout than any individual could have had in such a

process, but the deal itself cannot have been compromised. It would appear that in huge complex transactions like the SDP, the amount of information provided to explain the deal is ultimately self-defeating, as people cannot or will not develop a full understanding of the facts, preferring to subscribe to rumour and slander. At heart there is still a profound distrust of our democratic institutions, which will only be overcome by continuing down the path of openness and consultation.