# Financing misery with public money

## European Export Credit Agencies and the financing of arms trade

ENAAT Research Group

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## Introduction

**Few people know that public money is used to support the export of weapons to poor and/or war-torn countries. Financial support for military equipment, denied by international financial institutions such as the World Bank, is provided by Export Credit Agencies (ECAs). ECAs are (semi-)public loan guarantee agencies set up by governments which want to support exports to risky or unstable regions. Collectively, Export Credit Agencies account for the largest flow of official finance to developing countries. They are also the largest source of developing country debt[1]. Although the military share in ECA expenses is extensive, figures are largely unknown due to lack of transparency.**

Of all export credits issued or underwritten by European governments, between twenty and thirty percent are military-related, supporting the sale of a wide range of arms, aircraft, and naval vessels, as well as electronic equipment and civil—security requirements (such as tear-gas). This level of support is especially striking given that even among Europe's four major arms-exporting countries, such sales only accounted for two percent of total exports during the 1990s.[2] With ECA support, British Aerospace (BAe) Hawk fighter jets were exported to Indonesia during the Suharto dictatorship, and an armaments package worth $5 billion has been sold to South Africa by ECA-supported companies in Britain, France, Germany and Sweden, despite opposition from many in South African civil society who questioned the spending priorities. ECA backing even helped Saddam Hussein to build his private bunker network.[3] Currently, four warships worth more than ten years of development aid are being built for the Indonesian navy with a financial guarantee from the Dutch ECA, Atradius.

*Textbox 1*

### Arms in the portfolio of European ECAs

1. The United Kingdom (ECGD): between 23 and 50 % in 2000 - 2006, with an average of 38% per year.
2. France (COFACE): one third.
3. The Netherlands (Atradius-DSB): on average 27 % since July 2002, with a peak of 57% in 2004.
4. Germany (Hermes): between 0,5 and 9,4 % of all export credits.
5. Belgium (Delcredere) on average guarantees twenty percent of the value of all arms for which an export licence has been issued.
6. EKN from Sweden: between about 1% and 40% since 2000, with an average of 11%.

This brochure gives a summary of an extensive research report[4] exploring the role of ECAs from eleven European countries in supporting arms and other military exports to developing countries.[5]

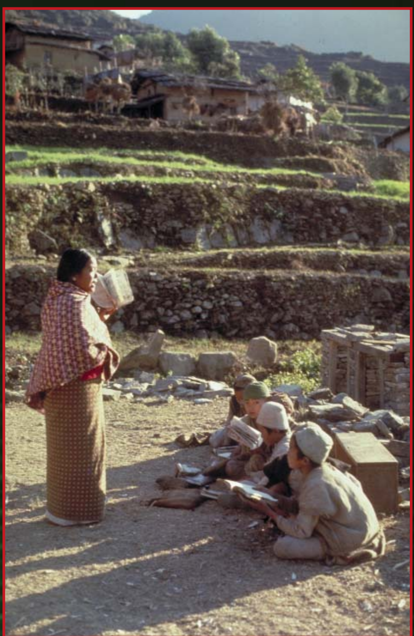
## What are Export Credit Agencies?

Export Credit Agencies are national, public or publicly mandated agencies.[6] They support exports by domestic companies to countries that are considered a commercial or political risk too big for conventional financing. ECAs provide direct loans, guarantees or insurance for commercial bank or exporter company loans. In return for a insurance premium the bank or exporting company is certain to get back its money, if not from its customer than from the ECA. Without ECA backing, many transactions would never take place. Given that ECAs are financed with public money, the use of ECAs means the financial risk of a transaction is transferred from the private to the public sector.

According to the UK government, the British Export Credits Guarantee Department (ECGD) lost €976 million on arms trade over a period of eleven years prior to 2002.[7] The premiums generally cover from a third to half of the claims for damages. For military goods, premiums only cover from twenty to twenty-five percent, making the ECGD's losses[8] on underwriting military guarantees higher than on the civil ones. British NGOs have compared ECGD premium rates with the premiums that commercial lenders would charge to companies exporting arms. Their research concludes that the ECGD provides an annual subsidy of €309 million to the defence sector,[9] reinforcing the argument that the ECGD subsidises the defence industry.

If an ECA needs to compensate a company, it will try to recover remaining payments from the recipient country.[10] If that recourse is unsuccessful, the remaining debt is added to the recipient country's national debt.

The World Bank, the International Monetary Fund and other international financial institutions do not fund military transactions. ECAs do. Without ECA support for military-equipment sales, many transactions would never take place. As a Midland Bank executive in charge of arms deals once put it: "You see, before we advance monies to a company, we always insist on any funds being covered by the (UK) Export Credit Guarantee Department...We can't lose. After ninety days, if the Iraqis haven't coughed up, the company is paid instead by the British Government. Either way, we recover our loan, plus interest of course. It's beautiful."[11]



## Military export credits and poverty

According to the United Nations' Development Programme (UNDP), military expenditures are a major barrier to reaching the UN Millennium Development Goals (MDG) for poverty reduction, health care and the protection of the environment.[12] Worldwide military spending averages ten percent of national public spending. For developing countries however, it amounts to fifteen percent.[13] Military spending competes with investments in **human development**; it often equals the amount spent on education and healthcare together. Again according to the UNDP, attaining the MDG is not possible without reducing military expenditure, since money spend on military development cannot be spent on human development.

*"Military spending often equals the amount spent on education and healthcare together"*

The second barrier the UNDP sees to attaining the MDG is the **indebtedness** of many developing countries. This is not only a problem for the so-called Heavily-Indebted Poor Countries (HIPC) but also for countries which are less heavily indebted. As with military expenditure, the costs of servicing the debt often far exceed spending on healthcare and education. According to different estimates, between fifteen and twenty percent of the total global debt is related to military expenditure.[14]

The World Bank sees **corruption** as one of the greatest barriers to development, severely affecting the poor.[15] Corruption can add twenty to thirty percent to the cost of government procurement[16] and may divert public spending away from human development areas, in which bribery returns may be small, to more lucrative sectors such as construction and defence. The corruption watchdog Transparency International states:
"Bribing foreign officials in order to secure overseas contracts for their exports has become a widespread practice in industrial countries, particularly in certain sectors such as exports of military equipment and public works. Normally these contracts are guaranteed by government-owned or -supported Export Credit Insurance schemes."[17]

While all EU governments have endorsed the Millennium Development Goals, by supporting military transactions with ECA guarantees, loans and insurance, the same EU governments create a major barrier to reaching these MDGs. Military over-expenditure, debts and corruption are part of military exports to developing countries and are contributing to continued poverty, misery and underdevelopment.

## Military export credits: debt generating transactions

Supporting exports through advantageous credit terms and low insurance premiums must be considered as export subsidies. To prevent the distortion of free-market competition, international regulations require ECAs to be cost-effective in the long term.[18] Cost-effectiveness means that premiums and repaid claims are sufficient to cover all costs. In most cases, ECAs are cost-effective only because they include debt repayments either by the recipient government or the supplying country's debt-reduction budget.

*"This enables ECAs to subsidise the defence industry even for exports to the poorest or most severely indebted countries."*

ECA support for military procurement transactions, however, is explicitly excluded from the requirement of cost-effectiveness. This enables ECAs to subsidise the defence industry even for exports to the poorest or most severely indebted countries that, most likely, will never be accountable for debt repayments. OECD (Organisation for Economic Cooperation and Development) members have agreed not to lend money to the poorest countries for unproductive expenditure, but this does not preclude support for equipment considered essential to national security or required to combat, for example, the drugs trade, smuggling, or piracy.[19] This opens the door for all kind of military supplies, because 'national security' may cover almost the full range of weaponry and equipment.

*Textbox 2*

**British credit support for Indonesian weapons: UK taxpayers foot the bill**

Although it does not have HIPC status, Indonesia's purchase of Scorpion tanks and Hawk fighter aircraft in the 1990s raised a lot of controversy and was opposed by British and Indonesian NGOs. British ECGD made the deal financially possible. In late 2004, Indonesia still owed €127 million to the ECGD for this deal. The British newspaper, the *Guardian*, revealed that: "In the last six years, the taxpayer has paid ?645 million (€883 million) to arms firms for failed deals with Indonesia." The ECGD still hopes to get some of its money back.

Meanwhile, Indonesia continues to borrow money for defence procurement programmes. Since 2000, military transactions accounted for at least fifty percent of all import-related debt. Furthermore, in 2001 and 2002 all export credit to Indonesia was allocated to the defence sector. Russia lent Indonesia €742 million to update its military with Russian fighter planes, while Poland lent the country over €193 million for transport planes. The Netherlands chipped in with more than €1 billion for four naval vessels (corvettes). According to an American defence official, weapon deals like these are not possible without low–interest loans and a flexible financing program. Indonesia spends almost fifteen percent of its annual budget on its armed forces, compared to the global average of ten percent. Debt repayments cost the country double what it spends on health care and education together.

*Sources:* Rob Evans, 'Taxpayers paid £400m to BAE for failed arms deals,' *The Guardian*, 20 December 2004; 'Defence Procurement and Military Related Debt', Andi Widjajanto, *The Jakarta Post*, 13 June 2005; 'Defence Export Credits' Andi Widjajanto, INFID, 2006; 'Guns or Growth. Assessing the Impact of Arms Sales on Sustainable Development', Oxfam International/Amnesty International, 2003, footnote 37; 'Indonesia Inks Deal to Purchase 10 Skytruck Planes from Poland, 6 June 2006; 'Air Force to Buy Six more Sukhois', *The Jakarta Post*, 6 June 2006.

Arms transfers are debt-generating transactions for the purchasing countries, because they are non-productive expenditure. They do not generate added value to a country's economy. A paper mill generates products to finance its costs and to repay its original purchase. Arms generate nothing productive. They do not contribute to the possibility of recovering the purchase-price. Therefore OECD members have agreed not to register the cancellation of military debts as development assistance, since military transactions do not contribute to the economic growth of developing countries. It is however unclear whether, or how, this agreement can be implemented, because in most cases it is not specified whether a debt is civilian or military.

## Corruption

According to the American Chamber of Commerce, fifty percent of all bribes paid worldwide between 1994 and 1999 related to trade in arms.[20] CIA estimates come to forty to forty-five percent.[21] This is remarkable, as sales by the global arms industry only make up one percent of world trade. It is, then, hardly surprising that many large ECA-backed arms deals - such as those to South Africa, Indonesia and Saudi Arabia - have been surrounded by allegations of widespread corruption.

*"Fifty percent of all bribes paid worldwide between 1994 and 1999 relate to arms trade."*

Several OECD regulations aim to combat bribery.[22] However, the payment of commissions to agents is generally accepted as part of normal business. In the arms trade however, more than elsewhere, commissions are problematic as they are often synonymous with bribes to corrupt officials. No ECA has consistent interdiction procedures in place when a company is convicted for corruption, nor is it routine policy to check the agents who receive commissions. Since ECAs do not publish the terms of the policies they issue, it is impossible to judge whether the commissions paid are in proportion with the delivered goods or services.[23] According to Dieter Frisch, former Director-General of Development at the European Commission: "It is obvious that this practice (of including commissions in the amount covered by the export credit guarantee) constitutes an indirect encouragement to bribe."[24]

*Textbox 3*

### Bribes in SouthAfrica, silence in Europe.

One of the most controversial arms deals in recent years is a huge internationally-sourced defence package for South Africa, including 28 Swedish and 24 British fighter jets, 4 German frigates, 3 German submarines and 28 maritime helicopters, worth over €4 billion. Bidders for the contracts made payments in cash or kind to senior members of the South African government with decision-making power on who received those contracts. A contract was awarded to British Aerospace (now BAe Systems) which was €616 million more expensive than an Italian competitor's offer, despite the Italian jets being the preferred choice of the South African Air Force. British newspaper, the *Guardian*, revealed that BAE systems paid as much as €220 million in secret commissions to secure the contract. Prominent ANC leader, and former deputy President, Jacob Zuma is still under suspicion of being involved in unsavoury dealings involving the French company Thales' South Africa- subsidiary Thint. Meanwhile, German prosecutors are investigating payments of $25-million made by Thyssen (part of the German Frigate Consortium, GFC) to actors in the transaction. A senior official at EADS has already been found guilty of bribery in a Munich court and fined. The EADS case - which involved Mercedes SUVs as sweeteners, Diamler-Benz being a partner in EADS – also resulted in the conviction and gaoling of Tony Yengeni, former ANC MP and then-head of the parliamentary Defence Committee.

Although the corruption scandal received a lot of attention in the South African press, in the suppliers' European home countries there is a deafening silence. The deal is underwritten by British, Swedish, French, German and Italian ECAs it. None of the ECAs involved has instigated any investigation into the accused companies.

*Sources:* 'Underwriting Bribery: Export Credit Agencies and Corruption', Susan Hawley, The Corner House, 2003; letter from the *Bundesministerium für Wirtschaft und Technologie* to Paul Russmann, *Kampagne gegen Rüstungs export*, 17 March 2000; 'SEK annual report 2000; 'The Case for Removing Arms from the ECGD's Portfolio', Ann Feltham, Campaign Against Arms Trade; 'BAE 'paid millions' to win Hawk jets contract', Rob Evans and David Leigh, *The Guardian*, 30 June, 2003; Arms deal returns to haunt ANC, Andrew Feinstein, 11 February 2007
To follow the case see also the *Mail & Guardian Online* Zuma Special Report www.mg.co.za/specialreport.aspx?area=zuma_report


## Lack of transparency

In most European countries, there is not much information available on the relation between military exports and the policies of ECAs. Only for the Netherlands, Germany, the United Kingdom, Sweden, Belgium and France, are limited data available. Due to the lack of publicly-available information, using figures on the share of military goods within the portfolio of the European ECAs can only be indicative. Positive examples are the Austrian ECA (OeKB) which does not guarantee any military goods [25] and the Swiss ECA which excludes lethal weapons from its support.[26]

ECAs are mostly backed by public money; it is essential, therefore, that they operate to the highest standards of transparency. At the moment, the majority of the European ECAs only publish very concise information – if any - on the insurance policies they issue. Information on the policies backed by ECAs is needed to gain more insight in the amount of military export credits, to prevent corruption and to make sure that the cancellation of military debts is not booked as 'development aid'. A greater degree of transparency will also create a level playing field for European ECAs.

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Transparency is also an important instrument in preventing ECAs from being party to the passing of bribes in the form of commissions. ECAs should be especially prudent when dealing with the arms trade, , since forty to fifty percent of all bribes are related to this sector. Recent scandals show that existing regulations are not sufficient in preventing corruption within major arms deals. Since the arms trade is less open then general trade, and since it is one of the most corrupt trade sectors, more stringent regulations should be in place concerning military transactions.

## Arms export policies

The European Union has a Code of Conduct on Arms Exports.[27] The Code aims to prevent arms being exported to countries with a poor record on human rights, to countries which are involved in regional or internal conflicts, or for which the procurement of arms would be at the cost of investments in human development. EU member states implement this Code of Conduct at the national level. However, once an Export Credit Agency backs an arms deal – which often happens before the export licence is issued - the government becomes a financially interested party. For example, the Netherlands decided to export two corvettes to Indonesia (see textbox 3). According to the Minister of Economic Affairs the Dutch government risked losing €1 billion, if the human rights situation in Indonesia deteriorated and granting an export license became inappropriate. This example shows that financial involvement is conflicting with the government's official role as an independent supervisor on arms sales.

*Textbox 4*

### Examples of ECA backed arms deals

**Tanzania**

In 2003 the Belgium ECA Delcredere supported the export by New Lachaussée of equipment for an ammunition factory in western Tanzania. Apart from the fact that Tanzania is a poor and highly indebted country, the deal raised a lot of opposition because of the severe risks of the ammunition being exported to war-torn Congo. The Walloon government in 2005 finally revoked the arms export licence. Delcredere compensated New Lachaussée for the losses.

**India and Pakistan**

Involved in a long-standing conflict on Kashmir, these two south Asian countries are a interesting market for arms exporters. With support from their national ECA Swedish, German, Belgian and Dutch defence companies have supplied fuel to the arms race between these two nuclear powers. Since from 2001 both India and Pakistan have started a new round of massive arms purchases. The number of people in India below poverty level is 800 million, in Pakistan it is 40 million.

**Saudi Arabia**

According to Amnesty International Saudi Arabia has a dire human rights situation, a widespread corruption and a severe lack of democracy. This doesn't stop Britain, Belgium and Germany, supported by their national ECAs, from exporting arms to the kingdom. Corruption scandals continue to erupt around the infamous multi-billion UK-Saudi Al-Yamamah deal.

**Nepal**

Just before Nepal received the status of highly-indebted poor country (HIPC) and became eligible for debt cancellation, Belgium facilitated a new loan for the procurement of machine guns by the Nepalese government. Although there was a civil war going on in the country, which has been reason for Germany to refuse the machine gun order.

*Sources: 'SEK's lending is reaching new records', MARKET WIRE, August 30, 2006; 'Interim Report for the period 1 January – 30 June 2006', AB Svensk Exportkredit (SEK); web.amnesty.org/report2005/sau-summary-eng; 'Parliamentary auditor hampers police inquiry into arms deal', David Leigh* *and Rob Evans, The Guardian, 25 July, 2006; 'Antwort der Bundesregierung auf die Kleine Anfrage der Abgeordneten Paul Schäfer (Köln) Heike Hämsel, Katrien Kunert, weitere Abegordneter und der Fraktion der DIE LINKE: Hermes-Bürgschaften für Rüstungsexportgeschäfte', Drucksache 16/1756' and Letter from the Bundesminesterium für Wirtschaft und Technologie to Paul Russmann, Kampagne gegen Rüstungsexport, 17 March 2006; ECGD's annual reports; EKN annual reports; Atradius; Bulletin nr: B023 – Schriftelijke vraag en antwoord nr: 0165 – Zittingsperiode: 51, Ministry of Economy and Scientific Research; Bulletin nr: B123 – Schriftelijke vraag en antwoord nr: 128 – Zittingsperiode: 50, Ministry of Economy and Scientific Research; 'In cahoots with the king. British aircraft are used in indiscriminate assaults against civilians in Nepal's war on Maoist insurgents' Isabel Hilton, The Guardian, 11 April, 2006. Human development report 2006.*

## Conclusions and recommendations

Military expenditure is a major barrier to reaching the United Nations Millennium Development Goals. Money spent on arms cannot be spent on human security needs, such as health care and education. Arms exports with ECA backing are likely to add to the debt of poor countries. Arms deals are notorious for corruption.

Moreover, arms exports are likely to aggravate conflicts, thereby contributing seriously to poverty and hampering development.

There can only be one conclusion: ECA support for military exports to poor countries is contributing to misery with public money.

We therefore recommend that:

**1-To prevent the arms trade from contributing to debt, and to stop ECAs from being a barrier to the Millennium Development Goals, the OECD should expand its non-productive expenditure criterion to include arms sales and to cover all developing countries. European ECAs should press non-OECD ECAs to adopt this policy as well.**

**2-The OECD, the European Union and individual European states should call on ECAs to publish information on each transaction. This information should at least include the value covering the transaction, exporter, date of ECA support request, recipient country and end-user in the country of destination, exported goods or services, financer and commissions. Forthcoming insurance policies (contracts) should be announced publicly at least ten days in advance.**

**3-ECAs should debar companies sentenced for paying bribes.**

**4-Because the use of ECA financial facilities hamper the functioning of the European Union Code of Conduct on Arms Exports, the EU should seriously consider excluding military sales from the portfolio of their export credit agencies altogether.**

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[2] Table II: Arms Transfer Deliveries and Total Trade, 1989-1999, By Region, Organization, and Country from *World Military Expenditures and Arms Transfers, 1999-2000.*
[3] John Pilger, `Distant Voice,' Vintage Books, 1993 (see: http://www.thirdworldtraveler.com/Pilger_John/Bloodfest_DV.html).
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Research was conducted by Nick Hildyard (The Corner House, United Kingdom), Rolf Lindahl (The Swedish Peace and Arbitration Society), Francesc Benitez (El Centre d'Estudis per la Pau J.M.Delàs), Cristopher Steinmetz (Berlin Information-center for Transatlantic Security, Germany), Nonno Breuss (Eca-watch, Austria), Sanna Rummakko (Peace Union, Finland), Andrea Baranes (Campagna per la Riforma della Banca Mondiale, Italy), Christine Eberlein (The Berne Declaration, Swiss), Sébastien Godinot (Les Amis de la Terre, France), Mich Crols (Forum voor Vredesactie, Belgium), Ann Feltham (Campaign Against Arms Trade, United Kingdom), Wiert Wiertsema (Both ENDS, The Netherlands), Martin Broek (Campagne tegen Wapenhandel, The Netherlands).
[5] All countries eligible for official development assistance according to the OECD-DAC.
[6] Although there also private ECAs, these fall outside the scope of this report.
[7] *House of Commons Written Answers*, Ms Hewitt to Mr Stinchcombe MP, 4 February and 21 June 2002.
[8] Idem. .
[9] `*Escaping the Subsidy Trap: Why arms exports are bad for Britain*' Paul Ingram and Roy Isbister, British American Security Information Council, Saferworld, Oxford Research Group, 2004, p. 41.
[10] A key characteristic of ECA support for an export or investment deal is the so-called counter-guarantee from the government of the developing country pledging payment in case of default. If the receiving company fails to pay for the exported equipment, the exporter and its bank will submit a claim with the ECA. The ECA will provide compensation under the insurance scheme on behalf of the domestic government. This government will claim the full nominal amount of the original transaction from the government of the receiving country, and add this to other export credit claims on that country. For arms exports the situation is different, since the recipient already is a government.
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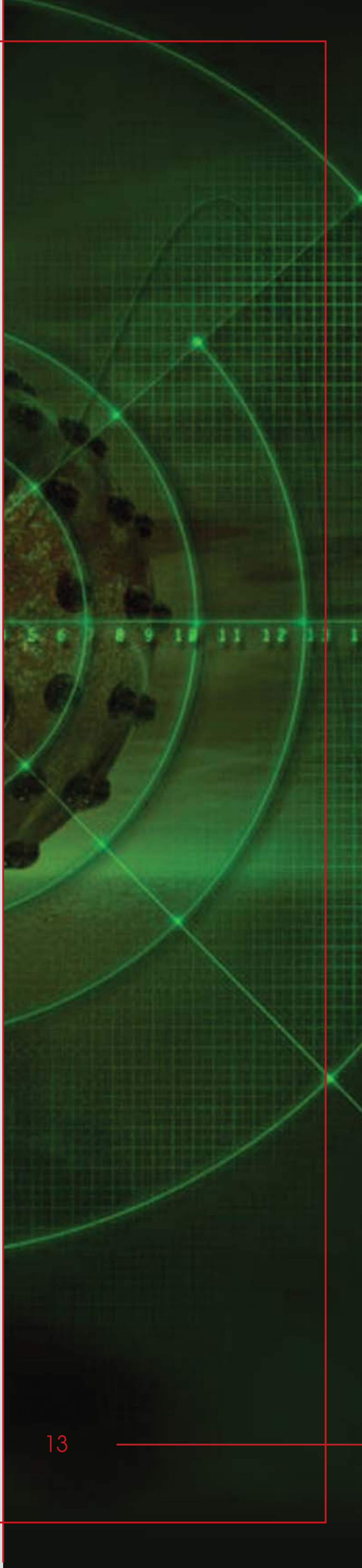

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[22] '*Convention on Combating Bribery of Foreign Public Officials in International Business*' (1999) and '*OECD Working Party on Export Credits and Credit Guarantees: 2006 Action Statement on Bribery and Officially Supported Export Credits*' (May 2006)

[23] More on the strength and weaknesses of the OECD anti-bribery policy: http://www.eca-watch.org/problems/corruption/ecaw_oecd_bribery_press_advisory_16may06.htm

[24] '*Export Credit Insurance and the Fight against International Corruption*', Dieter Frisch, Transparency International, 1999, p.23.

[25] This policy has been in place since 1994. OeKB's General Business Conditions states: the guarantee does not cover claims arising from the delivery of goods, which are subject to the regulations of the Federal Statute on the import, export and transit of war materials or to those of the Statute on security control.

[26] This means the company does not guarantee tanks or weapons, but would give a guarantee to a specially designed police car with Swiss technology or something similar.

[27] http://ue.eu.int/uedocs/cmsUpload/08675r2en8.pdf

[28] 'Exportkredietverzekering, sondages en wapenexportvergunningen', letter from the Ministry of Economic Affairs to Parliament, 27 June 2005.


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191


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Few people know that the export of weapons is often supported by public money. European Export Credit Agencies provide loans, guarantees or insurance for the sale of military equipment to poor and/or war-torn countries. Export Credit Agencies account for the largest flow of official finance to developing countries. They are also the largest source of developing country debt and a major barrier to reaching the UN Millennium Development Goals for poverty reduction.

This brochure gives a summary of an extensive research report exploring the role of Export Credit Agencies from eleven European countries. It includes conclusions and recommendations for EU governments and the OECD.

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EUROPEAN NETWORK AGAINST ARMS TRADE