

Research Paper

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The Defence Industry, Investors and the Arms Trade Treaty



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Summary

With near-to-global functions and supply chains, the activities of the defence industry touch a wide variety of actors working in different regulatory frameworks across the world. Formerly quite secretive and functioning in a relatively closed environment, defence businesses and the governments that support and regulate them have in the past decade come under increasing policy pressure by regulators, investors and the society at large demanding more transparency and less corruption, as well as social responsibility and sustainability.

The landscape of defence procurement and business is in constant transformation, and the global defence market in 10 years' time will look considerably different from today's, as many of the countries that now are large importers will become tomorrow's exporters. Furthermore, given an increasingly competitive market and the drive to reduce costs and to engage in emerging markets, the lower end of the supply chain could expand into emerging economies.

Despite a range of instruments developed at national, regional and now also at international levels, legally traded arms still too often end up in the hands of terrorists and criminals and in places where they are used to fuel insecurity, armed violence and conflict or for the purposes of internal suppression, inhuman and degrading treatment and other major violations of human rights and fundamental freedoms. These serious potential consequences of the trade, unintended or deliberate, are also quick to make headlines, posing reputational and even operational risks to defence companies.

The new legally binding rules introduced to regulate the international trade in conventional arms by the Arms Trade Treaty (ATT) – adopted by the UN in 2013 and in force from December 2014 – establish common criteria and international minimum standards to govern the trade in conventional arms that are likely to have a significant impact on the defence industry and the industry actors will be one of the key stakeholders in bringing the ATT into effective reality.

Currently, national practices and required procedures vary widely, posing challenges to ever-globalizing industrial actors who, in many cases, must simultaneously comply with different national regulations and apply different criteria even during a single trade transaction. Most defence companies operate in a heavily regulated and controlled national environment. However, the business environment is in danger of becoming ever more divided between actors striving to be responsible, accountable and transparent, and those who utilize regulatory loopholes to gain market advantage by being lenient on issues such as transparency or end-use controls. This is an unsustainable situation, and one that only a truly global treaty such as the ATT can address.

Many large financial actors – including those involved in banking, investment, insurance, mergers, acquisitions, lending, bonds, consulting and equity capital market activities – today follow some form of ethical investment criteria to assess an acquisition target and have policies regarding financing of industries related to armament and defence.

This paper analyses the role that both the defence industry and international investors financing the production and trade of military goods can have in the implementation of

the ATT, and makes a case for why it is beneficial for countries across the world to abide by its requirements and start implementing the treaty. It suggests some actions that could be considered in the coming years when implementing the ATT to further enhance its effectiveness and positive impacts on commercial actors and states representing both developed and developing economies.

As global supply chains continue to spread and evolve, the ATT is an opportunity for the new emerging powers and future exporters and importers of defence material to develop their control systems so that they are ATT-compatible, reliable and effective. The responsibility does not only lie with governments: companies of ATT states parties might find it reassuring that their governments and national regulatory bodies will be required to have explicitly considered several ethical and risk factors in the light of internationally agreed standards before allowing the transfer to go ahead; but in addition they need to present their ideas to governments and outline positions and questions that governments implementing the ATT will have to consider. To do this, the global defence and aerospace industry needs to develop its understanding of the ATT, the nature of the debate, the risks and opportunities, and the ways in which it can make a positive impact on its implementation.

Those considering acceding to the ATT should consider the following points.

- States should weight up the comparative advantage that joining the global treaty would bring to their national defence sectors: adopting a globally emerging norm is in the interest of the treaty actors in the UN and national governments, who therefore have to reach out more to the private sector to ensure optimal cooperation and build on one another's experience to ensure the full and comprehensive implementation of the treaty. They have to make the case to their industries that it is in their long-term interest to join global initiatives that otherwise might prove detrimental to their development. The ATT can prove crucially important to international cooperative agreements and joint ventures involving both the increasing ATT participation base and current non-members.
- As good practice, governments should incorporate an open-government approach to their aspirations regarding joining and implementing the ATT: their national defence industries should be kept in the loop on all necessary regulatory changes and be invited to contribute to their formation. As a practical measure, representatives from industry should be invited to participate as partners or advisers in all processes that will have an impact on that specific industry's business in the future, especially as the practice is already widespread among the NGO and research communities. There should always be a numerical balance in terms of external participation in national/governmental processes.
- To work more effectively with the private sector, the UN and national governments should continue developing their technical expertise and understanding of the functioning of the global defence industry to ensure that the ATT will stay on top of technical developments and will be able to respond to the future requirements of the defence sector.

The ATT could bring a definite comparative advantage to the defence industry as well. Therefore, defence actors and investors should:

- Develop a more active, structured and integrated approach to the treaty's implementation by more active involvement in national, regional and international decision-making. More active industry involvement should become a natural part of their corporate social

responsibility schemes; but it would also prove beneficial in order for businesses to take responsibility to protect their industry from new rules and regulations with which they might find it impossible to comply.

- Incorporate the new international norm established by the ATT in their day-to-day management and investment approaches to ensure that all actions conform with the treaty and can be marketed to both foreign governments and investors as added value and a potential enhancement of the business.

Introduction

Aerospace and defence companies that demonstrate leadership in the areas of ethics and sustainable innovation will be the winners of tomorrow. Therefore, investors have the opportunity to contribute to sustainability by investing in companies that demonstrate leadership by implementing sustainable business practices. By doing so, investors can benefit from high performance, while mitigating risks in the medium and long term.

Diederik Timmer, Sustainalytics Managing Director Europe

The volume of international transfers of major conventional weapons is currently estimated to be around US \$50–70 billion.¹ While much of the trade in major conventional arms is intergovernmental, the global spectrum of companies involved either as programme partners or through providing parts, components and services in the supply chain encompasses many thousands of actors from the developed world to emerging markets in the global South. They vary from research and development and the production of raw materials or forgings to finished parts and components, integration, financing, transportation, training, maintenance, repair and overhaul. The main consumers of the produced items are national armed forces – also increasingly spread across the globe – with some defence items also traded to private end-users.

The defence industry has in the past decades gone through dramatic transformations, in terms both of trade distribution and of the sector's overall size and structure. While production capacity, especially of small arms and light weapons (SALW), started spreading rapidly only by the end of the Cold War (Bevan, 2005, p. 39), the beginning of the 21st century has seen ever more countries developing their defence industries and export capacities (see, for instance, Global Security, 2013; Schipani, 2013; Grevatt, 2013). The bigger aerospace and defence industry sectors – especially in the West – are increasingly concentrated in the hands of a limited number of multinational conglomerates such as Lockheed Martin, Boeing and BAE Systems (SIPRI, 2014b; Dowdy, 1997). With near-to-global functions and supply chains, their activities have come to touch a wide variety of actors working in different regulatory frameworks.

If the sector itself has changed, so have the external environment and political climate within which companies in the defence sector operate: formerly quite secretive and functioning in a relatively closed environment, defence businesses and the governments that support and regulate them have in the past decade come under increasing policy pressure in a variety of areas, from simple demands for more transparency and less corruption to social responsibility and sustainability. While some have claimed for years that much of the arms industry continues to operate in a 'legal and moral vacuum' (Hillier and Wood, 2003, p. 55; Gangopadhyay, 2013), parts of it belong to the most heavily controlled industries of the world and have to comply with a growing number of national, regional and industrial regulations (CITS, n.d.). At the same time, questions have arisen about new, emerging powers, especially the BRICS countries,² which are increasingly seeking markets in places where regulatory requirements are laxer such as in Africa and the Middle East.

¹ According to the Stockholm International Peace Research Institute (SIPRI), 'the total value of the global arms trade in 2011 [last year for which data were available in July 2014] was at least \$43 billion. However, the true figure is likely to be higher.' SIPRI (2014a). Other estimates of the value go up to US\$85 billion (Oxfam, 2013).

² Brazil, Russia, India, China and South Africa.

The latest additions to the normative framework affecting the defence industry and investment are the new legally binding rules to regulate the international trade in conventional arms: the Arms Trade Treaty (ATT),³ adopted by the UN in 2013 and in force from December 2014, establishes common criteria and international minimum standards to govern the trade in conventional arms⁴ to be applied by states parties as part of their national export control systems, mainly for the purpose of avoiding their misuse and diversion to illicit markets. A major driving force behind the treaty was the need to improve international controls of arms transfers to prevent them from ending up in places where they might be used to commit violations of international humanitarian law (IHL) or human rights, or where they could fuel further violence and unrest instead of bringing the stability and peace that the arms trade is meant to serve, as also noted in the UN Charter.⁵

The ATT and the normative framework it establishes for the international transfer of conventional arms should also be seen in the wider context of changing business ethics: the past decade has seen the rise of different new norms for responsible and sustainable international business conduct, affecting a wide variety of sectors from the environmental to the defence industry.⁶

As part of this development, the investment sector financing the different commercial fields is under growing scrutiny. This applies also to its financing of weapon-related actors and international conglomerates, as investors are directly or indirectly questioning the ethics of supporting them (see, for example, Burley and Winchester, 2014; Lawn, 2013). This aspect of the defence sector has often been forgotten in the disarmament-linked policy debates around the nature and prospects of the arms trade. It is, however, an important background factor affecting both the scale and the nature of the international arms trade as a whole.

This paper analyses the role that the defence industry and international investors financing the production and trade of military goods can have in the implementation of the ATT, and makes a case for why it is beneficial for countries across the world to abide by the treaty's requirements and join it. The paper starts with an overview of the changing nature of trade in weapons, especially given the recent normative developments with regard to social responsibility. It then presents a short history of the industry involvement in the ATT negotiations, before looking in more detail at how the ATT could support a responsible role for the defence industry and investment, and vice versa. Where possible, it suggests some actions that could be considered in the coming years when implementing the ATT to further enhance its effectiveness and positive impacts on both states and commercial actors. Case studies included in boxes within the text are intended to provide further illustration of the types of issues in which countries might find the treaty beneficial, as well as issues that may not be part of the ATT as such but are intrinsically linked to the treaty's wider impacts and future potential.

³ At the time of writing in November 2014, the ATT had been adopted by the General Assembly under Resolution A/RES/67/234 B and ratified by 53 countries, thereby being set to enter into force on 24 December 2014 (UNGA, 2013, para 1; UN ODA 2014).

⁴ The categories of weapons included in the ATT are: battle tanks, armoured combat vehicles, large-calibre artillery systems, combat aircraft, attack helicopters, warships, missiles and missile launchers and small arms and light weapons. In addition, some provisions of the treaty apply to ammunition/munitions and parts and components (ATT (2013), Arts 2.1, 3 and 4).

⁵ As stated in the Purposes and Principles of the UN Charter, [T]he Purposes of the United Nations are: 'To maintain international peace and security, and to that end: to take effective collective measures for the prevention and removal of threats to the peace...' (UNGA, 1945, Chapter 1, Art. 1); and '[N]othing in the present Charter shall impair the inherent right of individual or collective self-defence if an armed attack occurs against a Member of the United Nations, until the Security Council has taken measures necessary to maintain international peace and security' (UNGA 1945, Chapter VII, Art. 51).

⁶ A groundbreaking initiative in the new framework is the UN Global Compact, an initiative established in 1999 to encourage businesses worldwide to adopt sustainable and socially responsible policies, and to report on their implementation. With over 12,000 corporate participants and other stakeholders from over 145 countries, it is the world's largest voluntary corporate responsibility initiative, stating ten principles in the areas of human rights, labour, the environment and anti-corruption (UN Global Compact, 2013).

Controversial Big Business in a Demanding and Risky Environment

The arms trade and defence manufacturing are inherently complex and divisive policy areas, not least given the controversies surrounding them: according to some, that whole area of business should be banned⁷ and investing in the defence trade is inherently unethical (Stearman, 2014; CUSU, 2014), while others underline the legality of responsible trade, the right of countries to defend themselves and the financial importance of the defence sector to national and international economies (Horner and Kimball, 2011; Stohl, 2014).

An issue that the defence industry is constantly tackling is the ever-increasing sophistication of products and their dual use: the same technology that might have been developed for military purposes might find wide application in the civilian field, or the other way round.

Additionally, in today's world, it is sometimes even difficult to determine which actors are providing actual military or defence items, as the definitions of weapons are becoming increasingly blurred and the supply chain is getting longer and more complicated. The components for complex weapon systems and platforms are often manufactured by many hundreds of companies working in different countries under different national regulations. Additionally, many of these manufacturers will not be actual 'arms manufacturers' as commonly understood,⁸ but simply general engineering or electronics companies engaged in a wide variety of non-military business. Even the components they manufacture for military use may be dual-use or entirely civilian and not even controlled (see Box 1).⁹

An issue that the defence industry is constantly tackling is the ever-increasing sophistication of products and their dual use: the same technology that may have been developed for military purposes may find wide application in the civilian field, or the other way round. A challenge in controlling these items is to strike the right balance between the need for protection of military technologies for national defence purposes, while at the same time ensuring that their legitimate civilian use is not blocked or overly hindered by checks, balances and secrecy.

⁷ See, for example, the Campaign Against Arms Trade (CAAT), www.caat.org.uk.

⁸ See, for example, Wikipedia's description of the arms industry and its actors at http://en.wikipedia.org/wiki/Arms_industry.

⁹ An example used by an interviewed defence manufacturer was the toilet seats to be installed in military aircraft. Despite their 'military application' their nature can be considered purely civilian.

Box 1: Illustrating the global nature and complexity of arms production and trade – the NH90 military helicopter

The supply chain for modern military products is often highly globalized, with several countries and companies working together to design, produce and deliver complicated defence systems, including conventional arms falling under the scope of the ATT. While the details of the supply chains for different products are often kept secret for business and security purposes, quite comprehensive information is available, for example, about joint ventures and general features of assembly.

One such example is the NH90 helicopter, a medium-size military helicopter that can be used for purposes ranging from the transportation of troops to naval combat missions.¹⁰ It was designed by NH Industries, a consortium of European companies¹¹ with its headquarters in Aix-en-Provence, France. The helicopter has been in production since 1995 and, as of July 2014, a total of 200 NH90s had been delivered to a variety of customers, with orders from at least 13 countries including Germany, Italy, France, Finland, Sweden, Australia, New Zealand, Oman and Belgium (NH Industries, 2014).

The helicopter's development was started in the mid-1980s by a team of European NATO countries: France, West Germany (BRD), Italy, the Netherlands and the United Kingdom. With some changes – the UK left the team quite early in the process while Portugal joined it in the early 1990s – the consortium has for the past 30 years been working on different prototypes and models of the same basic product. In addition to having changed over time, the NH90 has also been modified to fit the requirements and preferences of the different acquiring countries: for instance, the features of its cockpit and weaponry vary according to the buyer, and some countries have also negotiated the final assembly of the helicopters to be done nationally at their local sites.

The main assembly and exporting lines are based in Italy, France and Germany. Most of the major components are produced by each of the three shareholding companies, which use a variety of subcontractors and suppliers to provide the required parts and components (see Table 1 below). Items built by the different companies are then distributed to the various locations for assembly and flight tests, depending on the order in question and its required specifics. When transferring the parts and components, the companies working in the different countries – most notably when the transfer involves the United States or other countries outside the EU – have to deal with their varying export control regulations.

International and regional cooperation arrangements and instruments have in the past increasingly worked to simplify the regulatory framework of countries working together in joint projects like this, while at the same time maintaining the necessary controls over, for example, military and dual-use items.

Airframer, an independent directory linking aircraft manufacturers and their programmes with component and service suppliers, lists about 30 suppliers that participate in the manufacturing of NH90. Table 1 uses their listing, and shows some of the basic components of military helicopters, as well as the companies (and their main locations) that are relevant to the NH90 programme.

¹⁰ There are two main variants of the NH90: a tactical transport helicopter (TTH) for army use and a naval NATO frigate helicopter (NFH). Each general prototype is being produced with different subtypes and weaponry, as well as customized sensors and cabins (NH Industries (2014)).

¹¹ The company is jointly owned by Airbus Helicopters, AgustaWestland and Fokker Aerostructures.

Table 1: Selected components of the NH90 by category, company and HQ location

Type of item or service	Sub-category	Providing company/branch	Location of headquarters
Metals	Metal and alloy fabrications, sponson metal parts	Patricom Oy	Finland
Actuation components	Cargo ramp and hatch actuators and control units	Elektro-Metall Export GmbH	Germany
Electrical components	Wire harnesses	Indústria Aeronáutica de Portugal S.A. (OGMA)	Portugal
Lighting	Cabin lighting	Diehl Aerospace GmbH (joint venture of Diehl Aerosystems and Thales)	Germany
	Exterior lighting	ECE	Germany
Mechanical components	Exhaust equipment, exhaust deflectors	Aircelle	France
	Control grips	Guardian Electric Manufacturing	United States
	Cabin and console fans	TEMA	United States
Structural components	Structural and machined components	Production Parts Pty. Ltd.	Australia
	Metal, alloy, aluminium and titanium investment castings	TITAL GmbH	Germany
Airframe assemblies	Fuselage sections, rear fuselage	AERnova	Spain
	Fly-by-wire systems	Airbus Helicopters	France
	Fuselage systems	Eurocopter Deutschland GmbH	Germany
	Empennages	Fokker Aerostructures	The Netherlands
	Flight control systems	Liebherr-Aerospace Lindenberg GmbH	Germany
	Design and manufacturing of tools chain, cabin avionic bay	OMA SUD Sky Technologies SpA	Italy
Crew seating	Crew and cockpit seats	EADS Sogerma	France
Fluid power	Hydraulic low temp fluid filters	Aerospace Filtration Systems AFS	United States
Weapons systems	AN/ALQ-211 suite of integrated RF countermeasures	ITT Exelis, Electronic Systems	United States
Avionic components	Cockpit components and integrated control panel	ECE	Germany
Communications (airborne)	SP-1450 fibre optical link digital intercommunications system	Becker Avionics, GmbH	Germany
Indicators and instruments	Helmet-mounted displays, graphics and processor board plus computers for HMSD (with Thales)	Diehl Aerospace GmbH	Germany
Auxiliary power	Saphir 100 APU	Microturbo S.A.S.	France
Electrical power systems	Power electrical distribution boxes and power contactors	ECE	Germany
Engines	T700 engines	GE Aviation – Aircraft Engines	United States
	RTM322 engine	Turbomeca	France
Engine components	Engine cowls	US Silica Holdings, Inc. Comm (SLCA)	United States
	Full Authority Digital Controls (FADEC)	Triumph Engine Control Systems	United States
Fuel systems	Fuel pumps and valves	Secondo Mona SpA	Italy
Power transmission	Rotor drives: drive systems	UTC Aerospace Systems, Engine Systems, Power Transmission Systems	United States
Rotors and propellers	Spheriflex titanium main rotor hub with four blades	Airbus Helicopters	France
Manufacturing services	Final assembly of helicopters	Australian Aerospace Ltd.	Australia
	Final assembly of helicopters	Eurocopter Deutschland GmbH	Germany
	Final assembly of helicopters	Eurocopter Espana SA	Spain
	Final assembly of helicopters	Patria Aviation	Finland

Source: Airframer (2014).

As the brief illustration shows, the production process of large conventional military products such as combat and transport helicopters is complex, often involving suppliers and service providers in various locations, at different points in time and different levels of magnitude and military significance. Depending on the sensitivity of the components provided, some are likely to be controlled by the defence export control procedures of the countries in question while others can be transferred without specific regulation.

The ATT as a legal framework refers mainly to the export of the end products, such as the NH90 helicopters. However, its scope specifies that in terms of 'parts and components', each state that is party to the treaty 'shall establish and maintain a national control system to regulate the export of parts and components where the export is in a form that provides the capability to assemble' the conventional arms covered under it. Prior to authorizing the export of such parts and components, a country has to apply the treaty's transfer criteria listed in its Articles 6 and 7 (ATT, 2014, Art. 4).

Because of the volume of the global supply chain, the wording and the resulting coverage of the ATT in terms of parts and components were one of the main areas to which the defence industry provided input, trying to ensure necessary controls while avoiding an over-complication and bureaucratization of defence-sector activities.¹² Many defence actors therefore argue that the ATT will in fact be in the interest of all defence-sector businesses working in today's global environment as it can help reduce risks, enhance business accountability and help harmonize the current myriad of different regulations and requirements that companies have to deal with.

In addition to having gone through significant changes, the landscape of defence procurement and business is in constant transformation: while the trade is still dominated by a handful of big players in the United States, Russia, Europe and Israel, new market entrants are emerging, such as suppliers from Brazil, China, India and South Korea (Brück and Holtom, 2014). In addition, the global defence market in 10 years will look considerably different from today's, as many of the countries that now are large importers will become tomorrow's exporters (ASD, 2011). Furthermore, with an increasingly competitive market and the drive to reduce costs and to engage in emerging markets, it is possible to envisage the lower end of the supply chain being expanded into emerging economies.

The defence industry is also increasingly finding itself in stiff competition for new business, particularly in the emerging markets. Some governments have been introducing challenges and factors to differentiate bidders. Many countries have traditionally sought direct and indirect offset arrangements to derive value for their economies.¹³ If transparent and properly regulated, such measures are entirely understandable. In some cases, the perceived value of offset arrangements to companies can be such that they are even traded as credits for future projects (Hoys, Tsar and Amann, 2013). Recently, offset deals based on value have lost some of their attractiveness for countries that are seeking to develop their own industrial and defence capabilities. Instead, they are interested in access to the technology and work associated directly with the defence product and would prefer joint ventures or projects with indigenized production (Kanwal, 2014a; WRI, 2010). This embeds in any deal the possibility of significant portions of production or aftermarket support being established

¹² There are two main variants of the NH90: a tactical transport helicopter (TTH) for army use and a naval NATO frigate helicopter (NFH). Each general prototype is being produced with different subtypes and weaponry, as well as customized sensors and cabins (NH Industries, 2014).

¹³ Offset arrangements are contractual agreements between the supplier and buyer of defence projects whereby the supplier agrees to buy products from the buyer of the end product in order to win the buyer as a customer and offset the buyer's outlay. Generally the seller is a foreign company and the buyer is a government that stipulates that the seller must then agree to buy products from companies within their country (Hoys, Tsar and Amann, 2013).

‘in-country’. The technology transfer involved, including training and the construction of production facilities, further widens the network of expertise and new actors in the defence industry supply chain.

Some of the challenges facing the sector include environmental and safety concerns, social issues in terms of a strong trend to outsourcing production, and governance concerns such as managing and preventing bribery and corruption, which in the investment world are generally labelled as environmental, social and governance (ESG)¹⁴ issues (Eurosif and Sustainalytics, 2011). Bribes and off-the-shelf payments have traditionally tended to be part of the international arms trade, and some countries still expect these kinds of payments or the use of brokers to facilitate deals (Potter, 2011). Then again, Western defence companies are seeking to comply with some of the most rigorous anti-bribery and corruption legislation in the world, particularly US legislation that has extensive extraterritorial reach.¹⁵

Box 2: Problematic arms trading

In 2011, a large German small-arms manufacturer, Heckler and Koch, came under investigation by the police in connection with allegedly illegally exporting some 8,000 handguns and automatic rifles to embargoed regions of Mexico in 2006–09, guns that were later found to have been used in the country’s drug war. The company was also accused of deceiving the Federal Security Council, Germany’s government committee that adjudicates on sensitive export contracts in other export cases, ‘from South America to Syria’. The company denied any wrongdoing, but has since experienced some tough times: in 2013, it announced a debt of about €70 million a year after the ratings agency Moody’s downgraded it. A state prosecutors’ investigation into the Mexican case is expected to be concluded during 2014 (Knight, 2011; Knight 2014).

In Kenya, a scandal evolved in late 2010 as the country’s Department of Defence uncovered alleged bribery involving senior Kenyan Defence Force officers. The deal concerned the purchase of armoured personnel carriers from the South African company OTT Technologies (Pty) Ltd. Following a year-long parliamentary investigation, it was found that the irregular procurement of PUMA M26 armoured personnel carriers had violated multiple sections of the country’s Public Procurement Act 2005. In addition, the Kenyan business partners of OTT Technologies were identified by the US government as being involved in international crime and drugs smuggling, and it was recommended that the company be barred from doing any business with Kenya in the future. In 2014, the same company was accused by the government of Mozambique of irregular tax and export control activities in the transport of similar armoured carriers through Mozambique for suspected onward trafficking into other parts of Africa despite being officially deployed for the UN’s Multidimensional Integrated Stabilization Mission in Mali (Agina, 2010; Ongiri, 2011; Verdade, 2014; Nkala, 2014).

Similar examples can be found across the world, in different contexts and magnitudes and with varying judicial implications.

Despite a range of instruments developed at national, regional and now also at international levels, legally traded arms still too often end up in the hands of terrorists and criminals and in places where they are used to fuel insecurity, armed violence and conflict or for the purposes of internal suppression, inhuman and degrading treatment, torture and other major violations of human rights and fundamental freedoms. These serious potential consequences of the trade, unintended

¹⁴ ESG refers to the three main areas of concern that have developed as central factors in measuring the sustainability and ethical impact of an investment in a company or business. It is also known as ‘socially responsible investing’.

¹⁵ See, for example, <http://companies.defenceindex.org/>.

or deliberate, are also quick to make headlines, thereby posing reputational and even operational risks to defence companies (see Box 2). The business landscape is in danger of becoming ever more divided in two: actors striving to be responsible, accountable and transparent versus actors who utilize the loopholes of the regulatory landscape and seek to gain market advantage by being lenient towards issues such as transparency or end-use controls. This is an unsustainable situation, and one that only a truly global treaty such as the ATT can address.

Most defence companies operate in a heavily regulated and controlled national environment. Currently, national practices and required procedures vary widely, posing challenges to ever-globalizing industrial actors who, in many cases, simultaneously have to comply with different national regulations and apply different criteria even during a single trade transaction. The globalization of trade and the integration of economies in trade and finance have created pressure for common rules across the world. Also, when it comes to trading in defence products (Birdsall and Lawrence, 1999), the growing dependency on others for trade can be argued to increase the need for common policing, monitoring and information-sharing (Martin and Simmons, 1998).

Challenges with regard to different national practices are on the one hand related to the fact that some defence trade actors can ‘system shop’, in every case selecting the regulations that are most favourable to them, while, on the other hand, they can cause confusion, even among the responsible players. Despite the products and markets becoming ever more globalized, companies face a ‘global patchwork of systems ranging from very comprehensive to barely functioning’ (CITS, n.d.). The myriad of systems and different requirements make it easier for unscrupulous arms dealers to carry out grey or completely illicit operations, and they also raise the risk of responsibly traded weapons accidentally falling between the cracks and ending up in the wrong hands, with potentially devastating effects on the civilian population.

To combat this growing phenomenon, some governments have increasingly started to reach out to their relevant stakeholders, both internally and internationally, trying to showcase some of the lessons learned and problems encountered when working in a complicated and varied environment. Box 3 shows the example of the UK which, faced with rising attention and accusations from both the media and international actors (see, for instance, Hodges, 2014; Sengupta, 2013), has taken some steps to address the issue.

Box 3: Industry and national regulators working together – case study from the UK

As in many other countries, the authority for issuing or refusing export licences for defence material in the UK is divided between several government agencies: the main licensing authority is the Export Control Organisation (ECO) within the Department for Business, Innovation and Skills (BIS). Also the Foreign & Commonwealth Office (FCO), the Ministry of Defence (MoD) and the Department for International Development (DFID) participate in the decision-making, while HM Revenue and Customs, the Border Force and the Crown Prosecution Service are the regulatory agencies for enforcing actual export controls and penalties. The recently published joint mission statement for all the involved agencies is ‘to promote global security through strategic export controls, facilitating responsible exports’ (Dally, 2013). According to SIPRI, in 2013 the UK was the world’s sixth largest arms exporter, with its main clients being Saudi Arabia, the US and India (Wezeman and Wezeman, 2014, p. 2). Military exports make up about 1.5 per cent of total UK exports, with arms export employment accounting for 0.2 per cent of the workforce (CAAT, 2011).

The UK also has a range of public and private international trade promotion bodies which cover the defence sector. The main public defence-sector trade-promoting body is the Defence Services Organization of UK Trade and Investment (UKTI DSO), which in 2008 replaced the national arms export agency, the Defence Export Services Organization (DESO), that was located within the Ministry of Defence. Unlike its predecessor, the defence sector of UKTI is not directly under the UK government but remains affiliated to it with the remit to promote military exports. The BIS and the FCO are jointly responsible for its operations (Dally, 2013).

Among the regulatory agencies, the ECO also takes the lead in reaching out to industry and the academic community, with support from the other bodies. The main objective of the outreach programmes is to ensure exporters' compliance with the UK's export control legislation. Activities include providing the industry with information about current export control policies, processes and regulations, as well as the government's quarterly statistics about strategic export licence applications. The outreach projects also aim to assist exporters to interpret the policies and use the related practical tools, mainly through the organization of seminars and one-to-one support whenever requested.

As a new type of outreach project, the UK government has for some years worked with the Centre for Science and Security Studies at King's College London to implement 'Project Alpha', designed to improve the implementation of trade controls in order to prevent the proliferation of weapons of mass destruction (WMD). Aimed at key academics, researchers, business and industry stakeholders, the project is based on the idea that defence businesses and academia are often well placed to spot the possible illicit trade in arms and other defence items, and could work more with governments to tackle and eradicate the phenomenon. In order to feed their information about breaches and leaks to the system, the stakeholders must be aware of the current regulations, contact points and good practices.

In reaching out to academia, Project Alpha highlights that researchers working on sensitive topics should systematically consider proliferation risks, *inter alia*, when considering new research projects or overseas partnerships, publishing the results of their research or introducing courses and training. Within Project Alpha, some defence firms have voluntarily undertaken to work towards implementing the internationally recognized 'good practice guidelines' and inform others about their activities on this (Stewart, 2013).

One of the main lessons learned from the ECO's participation in Project Alpha has been that messages about export controls need to be tailored according to the audience: different stakeholder groups use different language to describe similar phenomena or risks, and the technical descriptions used within one group might not be the same in another. The project has also found that a crucial factor in success is often the efficient proliferation of the messages: readily available networks should be utilized and, as with the overall information, the means by which they are communicated have to be tailored to the audience.

Similar to the project's lessons learned from the WMD side of export controls, it could be argued that further outreach to industry, investors and academia would be beneficial in improving the controls on the conventional arms trade and in furthering the goals of the ATT. The public-private partnership implemented by the UK could probably serve as a useful starting point and provide valuable guidance for further similar developments in the field of international transfer controls of conventional arms (Dally, 2013).

For the past two decades, the dominating argument with regard to preventing weapons ending up in the illicit trade and the wrong hands (where they could be used to violate human rights or international humanitarian law, or to conduct criminal or terrorist activities) has been related to small arms and light weapons. Named as the ‘world’s favourite weapons of mass destruction’ (McCullum, n.d.) or WMD ‘in slow motion’ (Robinson, 2006), small arms have received the most attention with regard to controlling trade in conventional arms since they so easily could be used to violate human rights, break the international humanitarian law, or conduct criminal or terrorist activities. Separate regional and international instruments have been agreed to improve regulations over SALW.

The importance of this argument is in no way diminished; but the paradigm shifted considerably especially in 2014, mostly sparked by the events in Israel and Gaza, Syria, Iraq and Ukraine. Government-to-government sales of large weapon platforms have been called into question, and the transfer and use of sophisticated surface-to-air missile systems by non-state actors – including concerns that more sophisticated weapon systems could pose a safety risk to civilian air travel – have quickly eclipsed the previous concerns over light weapons such as MANPADS. This makes the implementation of the ATT ever more imperative.

Investing in the Defence Sector

As the defence sector and the arms trade have changed, so has the perception of investment companies and fund managers with regard to the production of and trade in sensitive items. The past decades have seen the establishment of several international and regional collaborative efforts to promote sustainable and responsible investment.¹⁶ Investors now regularly use ESG when assessing their possible defence industry investments (even though still only a relatively small number of companies publicly declare their adherence to them). The more ethical and human-security-related considerations have only started to increase during the last 10 years and seem to be prominent solely in extreme cases such as investing in defence procurement in conflict situations.

Most banks, insurance companies and investors now follow some form of ethical investment criteria to assess an acquisition target. Sophisticated buyers usually have two sets of criteria: one that is publicly disclosed and another that is used for internal review purposes. The most common publicly disclosed investment criteria include the geography, size of the investment or company targeted and the type of industry.

While some financial institutions have made a general decision not to invest in aerospace and defence companies, the sector continues to be a large and profitable part of international financial markets.

Investors are increasingly avoiding investments in companies involved in the production, transfer or stockpiling of weapons and, as a result of different international conventions and developing societal norms, a growing number of financial institutions are avoiding financial relationships with companies involved in the trade of weapon-related products (Eurosif and Sustainalytics, 2011). While some financial institutions have made a general decision not to invest in aerospace and defence companies, the sector continues to be a large and profitable part of international financial markets.

In the past, many large financial actors – including those involved in banking, investment, insurance, mergers, acquisitions, lending, bonds, consulting and equity capital markets activities – have adopted policies regarding financing of industries related to armament and defence. Some of them have decided to introduce guidelines and approval procedures for dealing with sensitive items (see Box 4), while others have stated they will attempt to withdraw progressively from financing the manufacture and sale of weapons altogether (HSBC, 2010).¹⁷

¹⁶ See, for example, the UN Global Compact (2013).

¹⁷ The HSBC policy does leave some room for manoeuvre with regard to the policy; for example, it excludes investments where the bank acts on behalf of its customers and where, consequently, the primary investment decision is not made by the HSBC. It allows the company to provide financial services to customers who provide non-weaponry defence-related products and services, and includes a transitory phase to accommodate possible defence-related deals acquired through mergers and acquisitions (HSBC (2010)).

Box 4: Crédit Agricole: one investor's approach to dealing with counterparties that have ties to the arms sector

Crédit Agricole (CA), one of the largest banking groups in Europe,¹⁸ publishes sectoral procedural memos regarding its investment policy. One of the current memos, originally published in 2010 and updated for 2012–16, sets out the company's general framework for dealing with companies in the arms and defence sector with respect to financing, investing and providing services to them.

The memo describes CA's operating principles applicable to counterparties with ties to the arms sector. In approaching the issue, the company makes a distinction between controversial weapons (mostly anti-personnel landmines and cluster bombs), sensitive weapons (containing depleted or any other type of industrial uranium, nuclear, biological and chemical weapons, as well as weapons of mass destruction), and 'other arms and defence equipment'.¹⁹ The last category comprises conventional arms and other military items, including munitions that are not dealt with in the other two groups.

As a kind of introduction, CA notes that it recognizes states' right to defend themselves and the fundamental role of the defence industry as a provider of defence items; the sensitive character of certain types of arms and challenges posed by different recipients; and the existence of international and regional treaties and agreements, including the ATT. As the memo dates back to 2012, it does not specify the ways in which the treaty might change the company's policy, but refers to it in general terms.

While the company generally refrains from doing business related to trade in the first two categories of defence equipment – covering landmines and cluster bombs as well as nuclear, biological and chemical weapons – it notes that investing in, financing and providing services to arms companies is authorized, as long as they are based in an OECD country. In addition, taking into account possible limitations, financing the following international trade transactions is authorized:

- Exports from any country to the European Union and
- Exports from any OECD country to a public entity or equivalent in the OECD.

Financing exports from a non-OECD country must be authorized by the Compliance Division, as must all exports where the recipient is not a public entity in the OECD region. The Compliance Division should also always be informed if a request comes from a country that is under an EU or UN embargo or similar, is in conflict or about which there are human rights concerns. Also, all actions involving brokerage should be consulted.

Financing for these operations must also meet the following conditions:

- The client must have been approved by the Financial Security unit from a Know Your Customer (KYC) perspective before the export date;
- The exporter and importer must have the administrative authorizations necessary for the transaction;
- Payment flows must comply with the conditions of the export contract and the beneficiaries must be the contractual parties; and
- The financing must not infringe the OECD Anti-Bribery Convention or local law.

¹⁸ According to its website, it is also 'the leading retail bank in Europe, number one European asset manager, bancassurer in Europe and global leader in aircraft financing'. <<http://www.credit-agricole.com/en/Group/Credit-Agricole-a-leader-in-Europe>>.

¹⁹ HSBC defines 'other weapons' as 'weapons which can be clearly identified, such as guns or missiles; platforms for weaponry, such as tanks and combat aircraft; and material parts of a weapon or a platform for weaponry with no generally accepted non-military uses, such as the turret of a tank' (HSBC, 2010).

While it is not currently mentioned, one could possibly foresee another criterion or consideration that could be added to the policy: whether the proposed sender and the recipient of the defence items are parties to the ATT, and an elaboration of their treaty compliance record.

A subsidiary of Crédit Agricole, CA Cheuvreux SA, which provides securities brokerage services, supported the investor statement in 2012 calling for a strong and legally binding ATT.

Sources: Crédit Agricole S.A. (2012); Röhrbein (2012).

In the end, companies' risk management and reputational activities all aim at maximizing shareholder value (which is not merely a function of their financial profits and future gains but also increasingly has to take into account ethical issues). Most large defence companies face regular examinations by their board (including non-executives), investors and even individual shareholders specifically to examine risks related to their business relationships and practices, as well as to measure their corporate responsibility (Lichtenbaum et al., 2011, p. 5).

Investors mostly rely on external analysis of risk and use input from the research community, the media and companies themselves to assess issues related to responsible arms trade, human rights and prohibited weapons such as anti-personnel landmines and cluster munitions. Effective export control compliance and other issues have in the past been included, for example in the Dow Jones Sustainability Index questionnaire, which addressed many specific aspects related to these areas and is tailor-made to deal with the specific risk factors related to the activities of different companies.²⁰

As the ATT matures, it could be foreseen that an element might be added about the participation of companies' host countries (or countries of operation) in the treaty or having in place substantially equivalent export control systems, and that this could count towards proving one's corporate responsibility and business sustainability. However, in order for the inclusion to be effective and meaningful, further awareness-raising and cooperation with the investment sector will be needed.

The approach of investors, banks and insurance companies towards climate-change-sensitive businesses is in many ways different from that of counting the risks of the legitimate arms trade; but the two branches are not totally without commonalities. Given the relatively longer-term involvement of, for example, the global insurance industry on climate change initiatives, it might be beneficial for the actors in the aerospace and defence industry to learn from some of the actions in the climate field to see whether the ATT could have a positive impact on their business, somewhat following the path of the climate change debate.

In 2010, a group of over 100 of the world's leading insurers issued a statement highlighting the potential benefits of using government action to enable the knowledge and expertise from the insurance industry to conduct climate-change-related risk management, especially in developing countries. The simplified idea behind the initiative is to try to facilitate investments that promote new, environmentally friendly technologies and help the global industry move towards a low-carbon economy in an environment that is 'one of a broad scope of risk management approaches that can facilitate adaptation to climate change and shore up sustainable development' (ClimateWise et al., 2010).

²⁰ The Dow Jones Sustainability World Index (DJSI World) tracks the performance of the world's largest companies that lead the field in terms of corporate sustainability. They are assessed annually by RobecoSAM using the Corporate Sustainability Assessment. Eligible companies are encouraged to actively participate in the assessment, *inter alia* by answering questionnaires about both general and industry-specific criteria relating to the economic, environmental and social dimensions of their practices (RobecoSAM (2013)).

It is not far-fetched to imagine a similar approach towards the international defence industry: as a legitimate business, yet one with many discrepancies, hurdles and huge humanitarian risks, the arms trade would definitely benefit from the wider involvement of financial institutions, investors and insurance companies to support more responsible businesses that would not risk contributing to human rights abuses, criminality, conflicts and undermining sustainable development.

Involvement of the Defence Industry and Investors in the ATT Process

Discussions about a possible international arms trade treaty started at the UN in 2006 following a decade-long campaign by various civil society organizations and prominent individuals. The majority of the defence industry companies were largely absent from the first years of the debate,²¹ which at the time was primarily framed as a human rights and human security issue. Industry considerations were not explicitly included in the views submitted by UN member states in 2006 about the ‘feasibility, scope and draft parameters for a legally binding instrument establishing common international standards on arms transfers’, even though many states mentioned the globalization of the arms industry as one of the main reasons behind the need to develop a global response as opposed to national or regional controls (UNGA, 2006; Parker, 2008, p. 9).

Commercial considerations were also not prominent in the work of the Group of Governmental Experts (GGE), which submitted its report in 2008 and did not, for instance, hear industry actors as part of its official deliberations. One reason for this was said to have been the general level of considerations which at the time did not allow for practical considerations to be included.²² The extent to which the industry – similar to many national and international NGOs – lobbied governmental representatives is difficult to assess; but there was no concerted industry lobbying or even interaction with the process at the time.

With the second ATT resolution, passed in December 2008, the General Assembly established an Open-Ended Working Group to meet for up to six sessions to further consider elements raised in the GGE report for inclusion in an eventual treaty (UNGA, 2008). Very few countries opted to include industry representatives in their national delegations. Only the US and European firearms industries joined the process through accreditation as NGOs rather than as part of any delegation. Given the size of the defence industry, knowledge about the ATT process among the industry actors was extremely limited.²³ The process was dominated by country communiqués and materials produced by NGOs.

In all but one or two cases, participants in the aerospace and defence industry seem to have been relatively disengaged from national ATT-related debates, with the possible exception of the United States. Outreach to industry regarding the ATT process was also very limited. This was particularly true for the US industry,²⁴ which is the largest in the world. The then US government’s opposition to the ATT process left US industry with a view that it was not relevant to them (this view changed as it became clear that the effect on multinational companies would be felt irrespective of where they were domiciled).

As the negotiation of the treaty built momentum and delved into specifics, the European and US defence industries became more involved. The Aerospace Security and Defence Industries Association of Europe (ASD) was the first group that came out publicly in support of an ATT

²¹ The industry representatives interviewed noted that before 2011, only a couple of defence industry experts took part in the UN meetings on the ATT. Even in 2011–12 the number of defence representatives was relatively limited.

²² Interview with a member of the ATT GGE (15 July 2014).

²³ Interview with the industry representative of the UK delegation to the ATT (28 July 2014).

²⁴ Interview with a representative of the US defence industry (25 May 2014).

by issuing a press release in early 2011 entitled 'Europe's defence industry supports strong, enforceable UN Arms Trade Treaty' (ASD, 2011). In the statement, ASD noted that the ATT would be a welcome step towards countering two 'complex and serious challenges': the globalization of the supplier base for conventional arms and the 'growing threat represented by the trade in, and the resulting global proliferation of, small arms' (ASD, 2011). According to the European defence industry participants, national coordination between the industry and relevant ministries prior to international deliberations was uneven; but towards the end of the negotiations most European defence industry representatives had established regular contacts with their national authorities and, where relevant, participated in domestic ATT coordination.²⁵ The ASD remained active in its internal coordination and the ATT was discussed in its Export Control Committee (ECC) as well as with different organizations from the industry and user community.²⁶ This was perceived as effective since both small and large industries from Europe were present, sharing one another's experience and needs. One representative pointed out that in their view the coordination should have been done by the head of the defence industry association in each country and not necessarily by the industry itself. It was also pointed out that, despite some defects in the formal coordination network, the people involved were enthusiastic about the mission and 'understood all the seriousness and what was at stake for our national industries'.²⁷

However, the number of active industry participants remained limited and regions were unevenly represented at the international level: in two series of regional seminars organized by the United Nations Institute for Disarmament Research (UNIDIR) as part of EU-funded outreach activities to support the ATT discussions and later negotiations, there were in total about a dozen industry participants, and the organizers often struggled to get in touch with representatives of the national defence industries who would have been well informed and willing to engage in discussions about the possible future treaty (Kytömäki, 2012).

As an attempt to get the private sector more involved in the ATT process, some of the active industry participants, supported by the NGO lobby, reached out to some of the largest investment companies, highlighting to them the process and its potential in lowering investment risk and increasing profitability. The campaign paid off: in the lead-up to the 2012 ATT Conference, a group of 39 institutional investors with US\$3 trillion of assets issued a statement calling for UN member states to support a strong, legally binding and comprehensive treaty. In their press statement they urged countries to negotiate an ATT that would 'prevent all types of international transfers of conventional arms and ammunitions where there is a substantial risk that these would undermine peace and security, be used in violation of human rights and international humanitarian law, or seriously impair sustainable development' and would 'include a comprehensive and detailed list of conventional arms, including small arms, light weapons, ammunition and components and equipment specially designed for arms' (Röhrbein, 2012).

As the UK Foreign Secretary William Hague stated in 2013 before the last stretch of negotiations, the treaty 'will not stigmatize the legitimate trade in arms. Instead it will protect it, establishing global commitments on national arms export controls and a baseline for robust controls that ensure countries can defend their citizens without undermining human development'. Indeed, in the future companies of ATT states parties might find it reassuring that their governments and

²⁵ Email exchange with three European industry representatives (July 2014).

²⁶ Email exchange with an industry representative who was closely involved in the ATT process.

²⁷ Email exchange with an industry representative who was closely involved in the ATT process.

national regulatory bodies will need to have explicitly considered several ethical and risk factors against internationally agreed standards before allowing the transfer to go ahead. This can provide some protection for the industry actors against possible accusations of irresponsible behaviour (Lichtenbaum et al., 2011, p. 5). Closing the gap between increasing institutional perceptions of risk and the positive effects of the ATT promised in this statement is a significant and challenging next step in the implementation and promotion of the ATT.

Currently organized mainly through PRI Clearinghouse,²⁸ a UN-backed global platform for collaborative shareholder engagement, the asset owners and investment managers who signed the statement come mostly from banks and other financial actors from Western Europe and North America.

The investment sector did not publicly react to the adoption of the ATT; but some national and regional defence industry associations – again mostly European – issued press statements welcoming the treaty (ASD, 2013; ADS, 2013). In private discussions, industry representatives highlighted the need to globalize the treaty's participation base to really 'level the playing field', as called for during the negotiations. In addition to harmonizing international standards, the ATT's added value was seen in its potential to make more countries improve their national regulation of the defence industry and its production.²⁹

A more predictable business environment could help countries to ensure that they introduce and implement at least the common minimum standards in their arms export controls and make the trade operations in the field more effective, responsible and reliable.

A common argument of the established defence industry players during the ATT negotiations was that the treaty would in fact not have much of an impact on them, as they were already operating under strict controls and the legal trade in arms was one of the most heavily regulated businesses in the world. Instead, it could help establish clearer common rules. A more predictable business environment could help countries to ensure that they introduce and implement at least the common minimum standards in their arms export controls and make the trade operations in the field more effective, responsible and reliable. This was emphasized by European businesses right after the adoption of the treaty and has been echoed ever since (Tigner, 2013; Ekklesia, 2014). However, there are voices of complaint and scepticism: in April 2014, the chairman of Europe's biggest arms manufacturer, BAE Systems, noted during a public press conference that the ATT would not have an impact on his business since, as a 'responsible company', BAE Systems 'already satisfies the requirements of the arms regulations of the UK government, which has signed the ATT'. This caused some NGOs to question the validity of the treaty, as according to them, '[A]ny treaty has to have teeth. It has to be stricter than the current legislation which affects countries like the UK' (Bermingham, 2014; Jackson, 2013). Yet the Western industry actors interviewed did not foresee the ATT making many changes to their operating procedures or environment, at least in its current form.

²⁸ For more information, see <http://unpri.org>.

²⁹ Email exchange with an industry representative who was closely involved in the ATT process.

Implementing the ATT – Possibilities for Constructive Global Industry Involvement

The ATT is not a traditional disarmament or arms control treaty, as its purpose is not to ban or delegitimize the international trade in defence products but rather to improve controls globally and demonstrate that the trade is being conducted in a reliable and transparent manner. It will do so by requiring all parties to assess their arms exports on the basis of common criteria including respect for international humanitarian law and human rights, combating terrorism and organized crime, and preventing possible diversion. As noted, governments were keen during the negotiations to ensure that the treaty would not be used to ‘question the suitability of arms sales decisions and develop an environment of international disapproval for major arms sales’, even though one of its major purposes is to enable the global community to set norms and act on inappropriate and illegal arms sales (Lichtenbaum et al., 2011, p. 6).

While some countries came to the negotiations with highly developed arms export policies extending beyond the requirements of the treaty and, in particular, large defence companies in the industrialized world already worked in a highly regulated environment, implementing the ATT will undoubtedly pose challenges to many. Overall, the ‘pros’ and ‘cons’ of states joining the treaty vary depending on their specific situations and the role and functioning of their defence industry. For instance, countries with specific, detailed export control lists will undergo some analysis as to whether and how joining the ATT would affect their functioning. Then again, countries with an emerging arms industry may benefit from joining the treaty mostly through the legitimization factor, although they also could incur short-term costs to the extent that their lack of export control delays and bureaucracy is a competitive advantage. Instead of being seen as a further hindrance to the operations of actors in the defence sector, the ATT should also be seen as an opportunity and an instrument that in addition to combating the negative effects of the arms trade, can have wider positive implications in promoting responsible industry involvement and transparency.

The defence industry encompasses a wide range of items and services, from ammunition and small arms to military technological applications, tanks and attack helicopter parts, for each of which the implications of the ATT will undoubtedly vary, and the implementation of the future treaty poses different challenges to the industry depending on the type of trade. As noted by the ASD, the more ‘high-tech’ weapons systems that fall under the ATT’s scope do not represent a major political risk in the international arms trade as a whole, because they are in most cases already very tightly controlled by the supplier nations and responsibly deployed by the recipients. That assumption may be tested in the future as recent events have shown that even large platforms, where contracts run for many years before delivery, can be subject to geopolitical risks. A large part of the risks, at least from the point of view of some of the industry actors, relates to the trade and control of less sophisticated items, such as small arms and light weapons, their ammunition, parts and components (ASD, 2011).

The benefits for the defence industry of an international treaty on the trade in conventional arms have been listed as the introduction of a common ‘language’ of regulatory approaches in different countries; the creation of a more level playing field in international arms transfers; the enhanced

corporate social responsibility of defence industry actors; and access to technological gains (Lichtenbaum et al., 2011; CITS, n.d.). Also, the feedback from industry actors since the adoption of the ATT highlights two main ways in which they see the ATT having a wide and long-term impact on the defence industry and its cooperation with states:

- The ATT will help states develop their national control systems, making them more robust, efficient and reliable/predictable, and help close regulatory overlaps and loopholes that currently complicate the work of many industrial actors in the field.
- By creating a common language of controls, the ATT will assist the defence and investment sectors to reduce reputational risks and operational costs, currently a result of having to deal simultaneously with multiple standards and procedures.

Weak regulations, inadequate interagency coordination and poor enforcement of arms exports – still realities in many countries – pose an inherent risk that transfer-related decisions are made with poor or no information at hand, and that they enable the evasion of controls and diversion of arms. Even in the regulated industry, some non-compliance is simply due to a lack of awareness and engagement by industry in governmental decision-making. As global supply chains continue to spread and evolve, the ATT is an opportunity for the new emerging powers and future exporters and importers of defence material to develop their control systems so that they are ATT-compatible, reliable and effective.

Box 5 briefly assesses the approach of two BRICS countries, Brazil and India, to the ATT both during the negotiations and immediately before its entry into force. The BRICS countries are some of the largest traders of conventional arms, with Russia and China among the top five exporters, and India and China in the top three importers (Wezeman and Wezeman, 2014). They have taken different approaches to the ATT: somewhat reserved about the treaty in the beginning, Brazil and South Africa signed it in 2013 and have publicly declared their commitment to the goal of a legally binding instrument that would regulate the legitimate trade of conventional arms and provide effective tools to prevent their diversion to the illicit market (Brazil, 2013; South Africa, 2013). China, the Russian Federation and India have so far taken a more cautious or sceptical approach towards the treaty, each from its own perspective and with somewhat different arguments. Russia has criticized the treaty since the beginning as having a noble objective but in the end falling short of establishing concrete measures to achieve it, especially when it comes to regulating arms transfers to non-governmental actors (Pukhov, 2013). In the ATT negotiations, India was of the view that the treaty text remained unbalanced, biased against importers and in favour of exporting countries. In addition, like Russia, India wanted the treaty to ban exports to non-state actors and to address the threat of terrorism more effectively (Mehta, 2013).³⁰ China said that it would not have stood against consensus at the ATT Conference of 2013 after the negotiation process had accommodated its red lines of excluding regional integration organizations from becoming parties to it and ensuring that gifts were not included in its scope. But it finally abstained from the General Assembly vote to establish the ATT, criticizing the treaty primarily for its implementation process (Bromley, 2013). The country has since spoken somewhat more favourably about the ATT, saying that in principle it has no difficulties with the treaty text and that it is currently undertaking an internal interagency process to analyse it (Fritz, 2014; Yun, 2013).

³⁰ For an overview of India's involvement in the ATT process, see Nepram (2008) and Prakash (2013).

Box 5: Brazil, India and the ATT – how joining the treaty can support emerging defence exporters

The cases of Brazil and India – one forthcoming and one slightly more reserved about the ATT – demonstrate that joining the ATT would not only play to the advantage of both their defence industries in the short to long term, but could also function as an example to the rest of the BRICS in highlighting the benefits of joining the new international instrument.

Brazil

Brazil is one of the largest exporters of SALW (Rigual, 2014) and the country's military industry is vibrant and growing fast. In addition to SALW, Brazil produces a range of other conventional arms. At its centre are Embraer, the world's third largest aircraft manufacturer, and Helibras, a combat helicopter manufacturer that now produces a range of armoured tanks, naval ships, aircraft and ammunition. Brazil's defence sector is going through major transformations, as identified in the national defence strategy of 2008 which sets goals up to 2030, and with projected defence expenditures for 2018 totalling US\$65.3 billion (Researchmoz, 2013). With partnerships and technology transfers as priority areas, the country seeks to empower itself and modernize the national defence structure, particularly in the cyber space and nuclear areas but also in conventional arms. Building international partnerships and cooperation is likely to remain central to Brazil in the years to come (WRI, 2010).

New merger and defence partnership announcements with South Africa and Angola can be seen as a part of this, showing how Brazil wants to unite its technological and research basis to start selling products 'not only for Brazil and Africa, but for the rest of the world' (Defenseworld, 2014; AngolaPress, 2014). Being part of the newly established international norm to create the highest possible international standards for the transfer of arms will undoubtedly be vital in this endeavour and open new doors to Brazilian products in markets that have previously been dominated by other players. It is also a great opportunity for a country with a relatively new and expanding export infrastructure to show its commitment to global values and the responsible trade in arms.

Having been criticized for lack of transparency and end-use controls (Santini and Viana, 2012), Brazil will be faced with new reporting requirements if it decides to join the ATT and continues developing both its indigenous production capabilities and foreign defence cooperation based on the new international norms on responsible arms trade.

India

As a large player in the global defence industry and the largest importer of conventional arms, India has a history of supporting various international disarmament and arms control instruments. Unlike many Western countries hit in the past few years with cuts in defence spending, India is firmly on track to modernize its armaments. Estimates of spending are around US\$100 billion by 2025, with current imports reaching over 70 per cent of total defence expenditure. Yet, partially based on its 'unpleasant experience' with the Nuclear Non-Proliferation Treaty and the Comprehensive Nuclear Test Ban Treaty, the country has remained sceptical about the intentions and potential of the ATT (Kanwal, 2014b; Praytush, 2013). One of its main reservations was that the treaty might affect the country's bilateral defence agreements, an issue that Article 26.2 attempts to address.³¹ India's defence industry, which has grown substantially in recent years, wants to continue supporting its indigenous domestic production capabilities while at the same time increasing its attractiveness to global defence companies (Dhawan, 2014, p. 51). For India, a major concern is also defence-related development in its neighbouring countries and regions, especially with regard to SALW (Prakash, 2013).

³¹ ATT (2013), preambular part.

With a new government since 2014 as well as recently renewed defence procurement and production policies, the country's defence market – which was previously dominated by state-owned firms such as the Defence Research Development Organization – is showing signs of opening itself to external actors. Like some of the other BRICS, India is increasingly seeking partnerships for technology transfers and off-set deals (Prakash, 2013).

Even though, unlike Brazil, India has not signed the ATT and abstained from the GA vote in 2013, it has declared that it 'remains committed to engaging actively and constructively for a balanced and implementable ATT' (Mehta, 2013), a good starting point to continue the country's international efforts in this regard. To build its defence sector further and to become an ever more credible partner in the international business, more efforts will have to be devoted to, *inter alia*, fostering talent, infrastructural reforms and a sound regulatory framework (Dhewan, 2014). The government announced in August 2014 that it was opening up its defence industry to foreign investors, allowing external defence contractors to own much bigger percentages of Indian military equipment makers than before, thereby potentially attracting billions of dollars of new investment (Choudhury, 2014; Rapoza, 2014). Indeed, given the country's current prioritization of the defence market, India 'has the potential to become an attractive destination for governments and companies around the world that need engineering services and components', just to mention two areas (Rapoza, 2014). In this, joining the ATT would be a definitive asset and proof of continued willingness to conform with the growing global norm of responsible conventional arms trade.

Overall, given the history of the BRICS countries' involvement in international arms transfers as well as their firm positions in representing the developing world, the potential ramifications of unregulated or insufficiently controlled trade in weapons should be familiar to them. This also demonstrates the humanitarian and development policy incentives to becoming part of the ATT. Accusations about less-than-transparent and corrupt trade practices should also be familiar to many of these countries (Pratyush, 2013; Santini and Viana, 2012). Showing a firm commitment to the goals and objectives of the ATT could reassure potential investors and collaborators.

Early accession of some BRICS to the ATT would show how the treaty can be beneficial to countries with emerging defence industries by supporting their image as responsible global arms traders and reliable trade partners in this challenging area. A remaining challenge for the ATT with respect to the BRICS will be to show that it will not seek to pose obstacles or unnecessary hurdles *vis-à-vis* their defence needs but rather that it seeks to support them.

Joining the ATT will naturally require some changes and developments in countries' national laws, regulations and administrative structures. The treaty's reporting obligations will also place new requirements on states whose arms transfers might in the past have suffered from opacity and secrecy. Being part of the overall deal, its requirements should be seen as encouraging opportunities rather than as an additional burden. While the real impact of the ATT may not yet be obvious on the ground or, for instance, in terms of supporting defence cooperation schemes in 2015–16, it will start affecting the global landscape of the legal, responsible arms trade in the coming years. It will be of crucial importance to emerging economies such as BRICS to be part of it rather than staying outside it.

Industry will play a significant role in helping to advance the true cause of the ATT, in the BRICS but also globally. The vast majority of defence companies at the top of the supply chain cascade their compliance requirements to their subtier suppliers through, for example, contract conditions, export control compliance requirements to prevent diversion of technology or goods, non-disclosure

agreements or supplier codes of conduct. Companies do this for three primary reasons: legal compliance (e.g. with export controls/security requirements), reputation protection and to underpin their commitments on corporate social responsibility (CSR). In their ability to reach into a global supply chain, even where suppliers are not based in the territory of an ATT signatory, the potential effect of such measures cannot be underestimated. This is starting to be reflected also in the defence industry's public statements, for example by the UK's defence industry organization:

Since 2003, the UK defence industry, with other European defence industries, has worked closely with governments and NGOs to ensure that the ATT becomes an effective mechanism for implementation for higher international standards in the defence export arena. The underlying security and humanitarian principles that drive the need for an ATT are consistent with the UK defence industry's strong commitment to corporate social responsibility (ADS, 2012).

The fear of some of the industry actors during the treaty negotiations was that the ATT might end up complicating their operational environment rather than concentrating on the essential, effective improvements. The promise of the ATT for the defence industry was that awareness about responsible business practices and risks related to international trade in defence *matériel* would increase beyond the companies and associations that became engaged with the treaty during its negotiations. Indeed, one of the most compelling reasons for a country to join the ATT will probably be that the treaty will reduce the risks related to its export controls, both in terms of existing markets and especially with regard to new competitor nations which have not yet adopted the same strict politics that traditional exporting countries have been utilizing for decades. In this sense, the two most central potential implications of the ATT for the industry – improved national control systems and an internationally levelled playing field – are mutually interlinked and reinforcing.

Both are also central to the future of global financing of the defence industry. Even though little has been written on the subject, irresponsible arms transfers negatively affect the global economy and investments. They are a risk factor for defence companies as they might be perceived to be complicit in human rights violations and other atrocities, thereby posing regulatory and reputational risks and challenges (CITS, n.d.). The ATT recognizes 'the legitimate political, security, economic and commercial interests of states in the international trade in conventional arms'.³² While this legitimacy is not brought into question in the treaty, those non-governmental institutions concerned with the risk of being associated with the defence business are becoming less sanguine. Clearly, arms transfers can potentially lead to those arms being used against the principles enshrined in the ATT. But investors, financiers and even freight-forwarders seem increasingly uncertain about even being associated with the arms trade.³³ This probably reflects a wider trend in risk avoidance that could be attributed also to other sectors, such as the civil nuclear industry or financial transactions connected with sanctioned countries, even where such transactions are allowed or can be approved.³⁴

The ATT specifically mentions the need to combat diversion (Article 11). It has been noted that the defence industry has a role along with governments and NGOs in detecting diversion. A partnership of trust needs to be built between industry and national licensing authorities. The industry actors need to be sensitized about unusual transactions, volumes, routes and watch lists (Geneva Forum and GCSP, 2014, p. 5). Many companies have individual guidance on detecting suspicious enquiries. Lessons can be taken from other industry sectors such as civil-nuclear energy, where elements of good practice have been promoted by a number of governments in the Nuclear Suppliers Group (NSG, n.d.).

³² ATT (2013), preambular part.

³³ Interview with a representative of a Nordic investment company (4 May 2014).

³⁴ Interview with a representative of the UK defence industry (26 May 2014).

As the previous sections of this paper have shown, the participation of both the defence industry and the investment community in the ATT has so far been quite limited. Interviews conducted as part of the research indicate a number of possible reasons for this. Many industry actors in most parts of the world do not seem to be very aware of the UN process or the resulting treaty, let alone its possible implications for their own activities. The working cultures of the UN and most businesses differ widely: as a diplomatic process, the ATT may have seemed too abstract or political for some industry actors to get involved in, or its lack of technical discussions may have caused them to perceive their participation as unimportant.

In some countries, defence businesses are closely linked with the government and trust that all possible international actions, including those related to the ATT, will be handled by the governmental authorities. Hence, national industries might not see the need to become involved in the regional or international implementation activities of the ATT or its follow-up and review meetings. Also, the possibility of some countries joining the treaty in the near future may seem so unlikely for their national industries that they do not see a real reason to get involved. Yet even if a company itself might not be affected, it will most likely come into contact with the treaty through being a subsidiary for companies that operate in an ATT state party or use subsidiaries placed in an ATT state party.

Industry involvement in a wide range of ATT implementation support activities will be central, not least because ‘it is the industry that has to live and deal with the practical parts when a treaty like the ATT comes into force’.

Finally, being part of an international process such as the ATT requires both financial and technical resources. As some industries are mostly concerned about their short-term business opportunities and have to work in a highly competitive environment, they may have calculated that its feasibility and the benefits were not sufficient for them to get involved.³⁵

It will require outreach, cooperation and assistance with regard to good industry practices and the possibilities of the ATT in order to achieve greater commonality of approach and to support all countries that want to join the treaty in doing so. Industry involvement in a wide range of ATT implementation support activities will be central, not least because ‘it is the industry that has to live and deal with the practical parts when a treaty like the ATT comes into force’, as one defence industry representative noted.³⁶ In this, the EU is implementing the first pilot projects. The Commission is currently implementing a follow-up activity on its defence industry communication of 2013. The second initiative is the ‘firearms package’, which the Commission will present in 2015. The main idea is to restrict the illicit use of firearms, which may also have consequences for weapon manufacturers.³⁷ The EU Council is incorporating industry aspects in its continued outreach efforts in relation to Council Decision 2013/768/CFSP. It envisages that states that abstained from the vote on the ATT in the General Assembly could be subject to targeted outreach activities in order to encourage signature of the ATT.

Positive industry involvement will be central for the implementation of ATT support activities from the point of view of the treaty’s own reputation: at the moment, many private-sector actors think of the international control treaties more as an additional burden and a restricting factor than something

³⁵ Based on an email exchange with three European industry representatives (July 2014).

³⁶ Email exchange with an industry representative, who was closely involved in the ATT process.

³⁷ Interview with an official of the EU Commission’s Directorate General for Enterprise and Industry (24 April 2014).

that could be mutually beneficial. As one defence actor put it in an example: ‘Due to UN regulations, industries have more and more difficulties to find an airline to ship their products, same with banks or insurance companies who don’t like to be considered as brokers.’ According to this source, it would be desirable if the UN could, for example, consider delivering some kind of ‘certificate’ for companies that, on the basis of monitoring and audits, are perceived as honest and respecting all regulations. Such certificates could help companies to find airlines or banks to work with, and could be regarded as an incentive for industry to support the ATT. Having the ATT in force from December 2014 with defence industry actors would also seem to necessitate some more structured efforts to enlist industry participation in the implementation process. It would help bring the industry in as an active participant rather than merely as the subject of controls, and give industry actors a bigger say in the future implementation of the treaty.

Conclusions and Recommendations

The role of the defence industry is acknowledged in the preamble of the ATT where UN member states recognize ‘the voluntary and active role that civil society, including non-governmental organizations, and industry, can play in raising awareness of the object and purpose of this treaty, and in supporting its implementation’ (ATT, 2013, preamble). The involvement in the ATT of defence industry actors and investors will be different from processes such as those on landmines or cluster munitions, as the goal of the latter is to prohibit and eliminate whole categories of weapons whereas the ATT aims at improving regulations for legitimate trade. From this it follows that while the crucial intervention point for industry in the Ottawa landmine process or during the negotiations on the cluster munitions convention, which both aimed at prohibiting a type of weapon, was made prior to their adoption, industry actors in the ATT remain central to the treaty’s implementation, and will possibly become even more important actors in the process as it matures.

It is hoped that, under the ATT, trading partners in the aerospace and defence industry will be able to communicate in a more universalized common regulatory environment, with fewer risks and uncertainties and improved transfer security, predictability and reliability.

As many states have pointed out, the Arms Trade Treaty will be ‘a floor, not a ceiling’ (TI, 2013). This concept works at two levels. At the treaty level, there is a possibility of amendments six years after entry into force. At the national level, states are free to go beyond the obligations of the treaty text in their own national systems. In order to fully address the perceived risk of connection to the arms trade it is in this latter area that governments, institutional investors and the defence industry need to work together to consider moves towards robust ATT control measures fortified by strong anti-corruption measures. As reported by Transparency International, two-thirds of the largest arms importers and half of the biggest arms exporters in the world currently have relatively weak anti-corruption controls (TI UK, 2014). All this needs to change, and a joint effort of the global industry, investment and governmental sectors will be needed to ensure it actually happens.

It is hoped that, under the ATT, trading partners in the aerospace and defence industry will be able to communicate in a more universalized common regulatory environment, with fewer risks and uncertainties and improved transfer security, predictability and reliability. The effects of the ATT will be different for different parts of the defence industry, depending both on the national regulatory framework within which they currently operate and on the type of items and services that are traded. Therefore, the ATT will need the support of regional and other groupings and experts’ communities.

To ensure the effective implementation of the ATT, further engagement with the international defence industry will be needed. This could consist of national and regional awareness-raising campaigns, but also more practical training and information-exchange events organized by the industry for the industry.

The ATT’s effectiveness will be measured by the number of participants it gains and by the actual difference it will start making on the ground in the next 10 years or so in changing the responsible legal trade and by curbing the illicit trade in arms. To support countries in their ratification efforts,

more technical guidance – highly relevant also to the defence industry – will be needed on how to implement the treaty in practice, addressing practical concerns of national and international actors.

The responsibility does not only lie with governments: defence companies and the defence-related industry need to put their ideas in front of governments and outline positions and questions that governments implementing the ATT will have to consider. To do this, the global defence and aerospace industry needs to develop its understanding of the ATT, the nature of the debate, the risks and opportunities, and the ways in which it can make a positive impact on the treaty's implementation.

In order to fully integrate the ATT into global investment schemes, information about its functioning and potential will have to be communicated to investors and fund managers. The development of a series of information booklets or webinars could be considered.

Therefore, states considering joining the ATT should consider:

- The comparative advantage that joining the global treaty would bring to their national defence sectors: joining a globally emerging norm is in the interest of the treaty actors in the UN and national governments, who therefore have to reach out more to the private sector to ensure optimal cooperation and build on one another's experience to ensure the full and comprehensive implementation of the treaty. They have to make the case to their industries that it is in their long-term interest to join global initiatives that otherwise might prove detrimental to their development. The ATT can prove crucially important to international cooperative agreements and joint ventures involving both the increasing ATT participation base and current non-members.
- As good practice, governments should incorporate an open-government approach to their aspirations regarding joining and implementing the ATT: their national defence industries should be kept in the loop on all necessary regulatory changes and be invited to participate in their formation. As a practical measure, industry representatives should be invited to participate as partners, participants or advisers in all processes that will have an impact on that specific industry's business in the future, especially as the practice is already widespread among the NGO and research communities. There should always be a numerical balance in terms of external participation in national/governmental processes.
- To work more effectively with the private sector, the UN and national governments should continue developing their technical expertise and understanding of the functioning of the global defence industry to ensure that the ATT will stay on top of technical developments and will be able to respond to the future requirements of the defence sector.

The ATT could bring a definite comparative advantage to the defence industry. Therefore, defence actors and investors should:

- Develop a more active, structured and integrated approach to the treaty's implementation by more active involvement in national, regional and international decision-making. More active industry involvement should be naturally grounded as part of their corporate social responsibility schemes; but it would also prove beneficial in order for businesses to take responsibility to protect their industry from new rules and regulations that might prove impossible to fulfil in reality.
- Incorporate the new international norm established by the ATT in their day-to-day management and investment approaches to ensure that all actions conform with the treaty and can be marketed to both foreign governments and investors as added value and a potential enhancement of the business.

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