

SECTION 7

THE ARMS TRADE TREATY AND THE CONVENTIONAL ARMS INDUSTRY



UN Photo: Harandane Dicko

The top 100 players in the global arms trade alone are reported to have sold US\$370.7 billion worth of conventional military arms and services in 2015.¹ Investors include state entities and public businesses, local manufacturers and multinational corporations, military service providers, financiers and many thousands of component, material and service suppliers. The trade employs large numbers of people, maintaining skills and manufacturing capacity that might otherwise be reduced. As a legitimate security and commercial interest in most countries, the arms industry has a considerable stake in the benefits of a fully implemented and effective Arms Trade Treaty (ATT). This section shows how the ATT provides certainty for industry actors by laying down reliable regulatory standards, not only for existing players but also for emerging manufacturers, exporters and states as they enter the market.

The second half of this section explores the vested interests of the conventional arms industry in the treaty, given the growth of corporate responsibility assessments across all sectors as a guide to investor and financier decision-making.

As reputation becomes increasingly important for corporate sustainability, it shows how effective ATT implementation can improve the image of the arms industry. Lastly, this section explores the additional benefits of the treaty as it combats the illicit arms trade by reducing black market supply. These are not separate factors, but they are interlinked and mutually reinforcing marketing advantages.

THE BROADER BENEFITS: ENHANCING TRADE STANDARDS AND IMPROVING MARKET VALUE

The ATT creates clarity in its support for a comprehensive regulatory environment,² providing exporters with clear risk-assessment criteria when authorising a shipment.³ This crucial step can avoid accusations of complicity in atrocities and human rights abuses caused through the misuse of arms and ammunition following a transfer.⁴

As the conventional arms market opens to emerging exporting states it will increasingly benefit both the existing industry and new players entering the trade.⁵ Current exporters have a stake in maintaining high regulatory standards to avoid being undercut by less scrupulous traders in an increasingly competitive market. For emerging exporters,⁶ the ATT offers international trade standards to aspire to along with a compliance framework to aid decision-making and to prevent unintended complicity in violations of international law.⁷

A trend towards a human security-centred approach

As another broader benefit, the ATT provides the private sector with a means to protect corporate image, an asset increasingly accorded value by stockholders, investors and financiers. As Corporate Responsibility Assessments support the trend towards a human security-centred approach to conventional arms and ammunition sales, the industry has a clear interest in incorporating the provisions of the treaty.^{8,9}

THE ATT PROVIDES CERTAINTY THROUGH RELIABLE REGULATORY STANDARDS

Trade globalisation has encouraged:

- value-added arms manufacturing and assembly practices;
- research and development;
- brokering, procurement and transfer supply chain complexity.

Often these changes have come more quickly than national regulatory controls can adapt.¹⁰ The privatisation of former state enterprises, such as ammunition and munitions producers, provides new business opportunities in the production of consumables.¹¹ This complexity is compounded when multinational corporations enter into long-term manufacturing and trade agreements in multiple jurisdictions with differing regulatory standards and systems.¹²

Such complexity can create gaps through which conventional arms may be diverted to illicit use, or employed in ways other than those agreed to by the exporting authority.¹³ As nearly all illegal arms sales begin as a legal transaction,¹⁴ ambiguity in domestic transfer controls can make it difficult for private industry to establish the legality of an international transfer.¹⁵ Conflicting requirements across a multi-jurisdictional supply chain can facilitate diversion, theft, looting and corruption.¹⁶

Factors which increase complexity in arms production, investment and trade include:¹⁷

- parts and components of conventional arms systems manufactured by a variety of companies in disparate regulatory environments;
- engineering, electronic or other subcontractors not involved in final assembly;¹⁸
- the growing complexity of value-added assembly and supply chains;
- the difficulty of categorising conventional arms whose parts and components employ dual-use technologies not controlled for civilian use.¹⁹

Before the ATT, different jurisdictions had a diffuse range of regulatory systems, all attempting to balance trade in arms with national security interests and humanitarian concerns.²⁰ Increasingly integrated and interdependent economies and globalised financial and trade systems created pressure for common rules.²¹

This is the first international, legally binding instrument to regulate the trade in conventional arms.²² If well implemented, the ATT is capable of harmonising the various regulatory approaches among States Parties in an increasingly interdependent world. The treaty aims to increase ethical and legal certainty by providing exporters with clear risk-assessment criteria in procurement and delivery processes. In this way it reduces the risk that trade agreements cannot be completed.²³

Regulatory benefits for all arms industry stakeholders

When considering the broader benefits of the ATT to the conventional arms industry, it is important to note that the benefits are not merely for industry actors—research and design, manufacturing and brokering—but increasingly for investors requiring certainty.²⁴ The finance industry—bankers, insurance companies and investment organisations—are often under pressure from stakeholders to reduce risks and to conform to ethical investment criteria.²⁵ International conventions and evolving societal expectations have caused a growing number of financial institutions to avoid relationships with companies involved in the arms trade for fear of reputational damage.²⁶ Makers and exporters of conventional arms and ammunition can easily earn a tarnished reputation in the wake of media, public and regulatory scrutiny which heightens public concern at irresponsible or illicit weapon transfers fuelling conflict and atrocities.²⁷

Standardised operational environments

The treaty will standardise operational environments and provide clarity as to the legality of arms procurement and delivery processes (see Section 2).²⁸ Operating under the protection of an ATT-compliant State Party can both enhance business opportunities and diminish the risk of complicity in violations of international law.²⁹ Sharing production and assembly between jurisdictions, for example in co-production licensing agreements,³⁰ becomes easier under standardised trade regulations. Exporters and importers working in a common regulatory environment will enjoy fewer risks and uncertainties, with improved transfer security, predictability and reliability.³¹ Clients will gain from streamlined procurement processes as they observe the expectations of responsible trade.

Trading in or from an ATT-compliant jurisdiction can be marketed as added value through corporate responsibility and corporate sustainability assessments to investors, and to foreign governments when negotiating a trade deal.³² Developing markets and emerging exporters can earn additional benefits if they operate under States Parties' jurisdiction, because operational clarity encourages regulators to develop national control systems. In these environments, arms traders can advertise their observance of ATT trade criteria to avoid breaches of international law.³³

AEROSPACE AND DEFENCE INDUSTRIES ASSOCIATION OF EUROPE (ASD)

*'The provisions (of the ATT) will not increase the administrative burden on European industry. They will, however, drive higher standards of regulation in countries that currently don't operate comprehensive controls. ASD sees this as a positive step. Increasing the number of countries operating common standards of control will provide more predictability and confidence for organisations that operate in a global market place and with global supply chains. A global solution is required to address this.'*³⁴

ASD press statement (3 April 2013)



UN Photo: Mario Rizzolio

THE ATT SUPPORTS INDUSTRY

The ATT can assist international arms procurement and trade in the same way that consumer protection guidelines set standards now seen as assets in many other sectors.³⁵ While treaty compliance establishes criteria by which consumers can judge arms transfers,³⁶ suppliers are able to cite assurances that their product will not be used other than agreed. The treaty enhances reliability and consistency in delivery, protects from false or misleading claims by parties involved, and empowers consumers who value ethical and legal integrity when choosing goods and services.³⁷

Existing multinational corporations will benefit from the ATT whether or not a base of operation is under the jurisdiction of a State Party.³⁸ As more states become parties to the treaty, exporters in non-party states will be required to satisfy ATT provisions imposed by transit and importing states that have adopted them. In this way the treaty levels the playing field for those operating under stringent export controls, minimising the disadvantage of competing with less scrupulous operators.³⁹

The ATT protects existing industry standards

Market analysts foresee that new states, private-sector manufacturers and exporters will enter the global conventional arms and ammunition markets during the next decade.⁴⁰ This puts the onus not only on governments to make ATT implementation work, but on existing businesses for whom this is a one-off opportunity to establish and protect industry standards as the sector opens to increased participation.⁴¹

Corporations that work with governments have the opportunity to communicate concerns and suggest improvements to regulatory behaviour.⁴² Governments can then communicate these views at ATT Conferences of States Parties—meetings held annually to consider developments in the arms trade, to review the implementation of the treaty and to suggest any adjustments required.⁴³ While the spread of ATT standards provides behavioural guidance for emerging suppliers, it also encourages existing providers to actively improve the treaty to their own advantage.



UN Photo: Ramadan Mohamed

The ATT helps reputable players stay ahead

The global value of all arms transfer agreements between states in 2015 was US\$79.9 billion, of which developing nations contracted for 81.7%.⁴⁴ The estimated value of actual international deliveries following these agreements was US\$46.2 billion, of which developing states accounted for 72.7%.⁴⁵ In the same year, global orders for conventional arms decreased.⁴⁶ Arms suppliers struggled to maintain market share⁴⁷ while purchasing states were often limited by domestic budget concerns. As a consequence, new sales in conventional arms have been more difficult to conclude.⁴⁸ As one report observed, to overcome obstacles in securing conventional arms agreements many suppliers 'have increasingly utilised flexible financing options, and guarantees of counter-trade, co-production, licensed production, and co-assembly elements in their contracts to secure new orders'.⁴⁹

These practices may result in an expansion of emerging economies entering the supply market as technology exchange and training advance domestic production capabilities. For example, China's conventional arms are often based on designs obtained from earlier licensed production programmes with Russia.⁵⁰ Another example is the world's largest arms importer, India, which recently reformed foreign investment legislation to allow up to 100% foreign ownership of domestic defence firms.⁵¹ Already, inflows of foreign capital and expertise are enhancing India's domestic arms industry.

The top traditional manufacturing states will progressively contend with more emerging markets manufacturing arms and ammunition.⁵² China reiterates that foreign arms sales, including to developing states, are an important market in which it intends to compete.⁵³ In coming years, historically large importers of conventional arms will instead become exporting states to emerging economies.⁵⁴

It is plausible that an increased number of supply options for the client will reduce costs in a competitive market.⁵⁵ This may result in a 'lower end' of the arms market supply chain to less affluent states,⁵⁶ while traditional arms supplying states continue to focus on established clients and more affluent developing states.⁵⁷ For this reason the arms industry may be in danger of becoming more divided between 'actors striving to be responsible, accountable and transparent, and those who utilise regulatory loopholes to gain market advantage by being lenient on issues such as transparency or end-use controls'.⁵⁸ This could affect consumers as treaty compliance allows the client greater access to high-tech systems not necessarily available at the lower end of the market.

As the ATT establishes a legislative framework and trade norms that assist those operating under stringent export controls, defence industries who operate responsibly will increasingly be matched with clients who value compliance and ethical behaviour to the disadvantage of traders in poorly regulated supply chains.^{59,60} Gradually, treaty universalisation will oblige low-end suppliers to adopt the more rigorous standards already observed by established suppliers of conventional arms and ammunition.⁶¹

The ATT provides an opportunity for companies operating in the jurisdictions of States Parties to ensure that future parties in emerging markets comply with expected behaviour and defend their reputation and competitiveness against unscrupulous actors.⁶²

By providing standard guidelines to avoid ethical and legal risks, the ATT framework opens opportunities to stay ahead of emerging competitors.

THE ATT ENHANCES REPUTATION

One of the most valuable corporate assets is reputation.⁶³ ATT compliance benefits reputation by preventing misuse of conventional arms by terrorists, organised criminals and repressive regimes.⁶⁴ Treaty observance can also protect corporate reputation by avoiding misuse of conventional arms to harm troops, contractors and diplomats.⁶⁵ Such events attract widespread media coverage and can damage the public image of the industry.

*'We do not want the legitimate trade to be tarnished in any way by the diversion of conventional arms to embargoed destinations, nor for use in acts that would violate international law ... We also welcome the fact that the Treaty is agreed by most member states—154 of 193 voted for—and that provides the best basis for securing the signatures of all states, particularly the major current and future arms exporters.'*⁶⁶

Gert Runde, Secretary-General, Aerospace and Defence Industries Association of Europe
press statement (3 April 2013)

The ATT enhances stakeholder value

'The Aerospace & Defence sector is often seen as prone to bribery and corruption...'⁶⁷ Although bribes are initially intended to generate business, the potential downsides for companies involved are substantial. Since governments are significant A&D customers and are often sensitive to maintaining appropriate business relationships, companies must be vigilant to counter bribery exposure in order to maintain their ability to win government contracts.

*'Corporate culture and reputation can be severely damaged as a result of bribery or corruption cases. The more material downsides relate to fines, legal costs and loss of licenses to operate or tender for new business.'*⁶⁸

Eurosif Aerospace and Defence Sector Report
Eurosif and Sustainalytics (2011)

Shareholder value is enhanced by companies' commitment to risk-management practices including protecting reputation. Increasingly defence companies' board members, investors and individual shareholders consider ethical issues and corporate responsibility in their search for security.⁶⁹ Stockholders, business partners and even freight-forwarders seem increasingly reluctant to be associated with the conventional arms trade and possible negative attention.⁷⁰ Investors and financiers view corporate responsibility as added value where it provides additional security against unforeseen events and share value turbulence.

While established and emerging arms traders, fund managers and investment companies specialising in production and trade of sensitive items⁷¹ seek advice on reputation management, groups such as Transparency International, consultancy firms⁷² and institutions such as the United Nations Global Compact and the Danish Institute for Human Rights provide Corporate Sustainability Assessment tools and scorecards to rank institutional responsibility.⁷³

UN Global Compact

*'The UN Global Compact is a strategic policy initiative for businesses committed to aligning their operations and strategies with ten universally accepted principles in the areas of human rights, labor, environment, and anti-corruption.'*⁷⁴

Guiding Principles of the UN Global Compact

Principle 1: Businesses should support and respect the protection of internationally proclaimed human rights;

Principle 2: Businesses should make sure that they are not complicit in human rights abuses.

Principle 10: Businesses should work against corruption in all its forms, including extortion and bribery.⁷⁵

As accusations of complicity can be levelled even in the absence of intent, the Guiding Principles of the Global Compact are important considerations for the arms industry:

- Direct complicity—when a company provides goods or services that it knows will be used to carry out the abuse.
- Beneficial complicity—when a company benefits from human rights abuses even if it did not positively assist or cause them.
- Silent complicity—when the company is silent or inactive in the face of systematic or continuous human rights abuse.⁷⁶



UN Photo: Mario Rizzolio

WHY SHOULD COMPANIES CARE?

Human rights

By disrespecting human rights, businesses face a number of potential hazards which might threaten their social licence to operate:

- reputational damage;
- consumer boycotts;
- exposure to legal liability and adverse government action;
- adverse action by investors and business partners.⁷⁷

*'Advances in information technologies and global communications mean that companies can ill afford to conceal poor or questionable practices...'*⁷⁸

*'Where an international crime is involved, complicity may arise ... where assistance had a substantial effect on the perpetration of the crime and the company knew that its acts would assist the perpetration of the crime even if it did not intend for the crime to be committed.'*⁷⁹

Corruption

*'... [C]ompanies whose policies and practices fail to meet high ethical standards, or that take a relaxed attitude toward compliance with laws, are exposed to serious reputational risks. Often it is enough to be accused of malpractice for a company's reputation to be damaged even if a court subsequently determines the contrary.'*⁸⁰

For more information see <<https://www.unglobalcompact.org>>⁸¹

Investors and the public often rely on risk analysis from the research community and news media to uncover arms trade complicity in human rights abuses.⁸² The UN Global Compact highlights the potential adverse impacts for industry when complicity in human rights violations acts as a disincentive for clients, who are mainly governments. Accusations of complicity in human rights violations can dissuade clients from continued arms procurement for reasons of principle. In one recent example a government intervened for political reasons in an export of cluster-munitions. Events such as these can seriously affect private actors unable to complete agreements.⁸³ Here the ATT would have provided guidance on the legality of the transfer, therefore helping to protect stakeholders from financial loss if transfer agreements could not be completed.

ATT compliance develops regulatory standards which close gaps for corrupt practices and encourage observance of human rights and international humanitarian law (IHL). In this way the treaty assists arms industry actors to enhance their reputation as a secure investment, or trading partners by minimising the risk of corruption and complicity in human rights violations.

THE ATT WEAKENS BLACK MARKET SUPPLY

Estimates put the value of the unregulated conventional arms trade at 10–20% of the annual turnover of the legal market.⁸⁴ Although the black market is unlikely to disappear,⁸⁵ the ATT can prevent new conventional arms and ammunition from entering the illicit trade. For example, the global average price for a variant of an Avtomat Kalashnikov (AK) rifle is US\$534.^{86, 87} Australia has reported an asking price of US\$15,493, compared to US\$75 in the Niger Delta,⁸⁸ and cost disparities between locations are commonly attributed to availability. There is even statistical evidence to suggest that low prices for AK variants increase the risk of armed conflict.⁸⁹ Here the ATT has a role to play in cutting supply to the black market, therefore avoiding diversion and misuse of product from the legitimate arms industry.⁹⁰

Correlations have been found between casualties in conflict zones and the availability and price of ammunition in neighbouring states.⁹¹ As ammunition is a consumable, the ATT can weaken black markets by reducing supply.⁹² A sudden shift in the price and availability of illicit ammunition can also correspond to a price reduction in compatible firearms.⁹³ Legitimate ammunition and munitions production is an important market for stakeholders to protect as it is expected to grow from US\$18.08 billion in 2016 to US\$21.98 billion by 2021.⁹⁴ Hence, the treaty can provide competitive advantage for the lawful production and secure transfer of consumables by restricting unlawful supply.

UN Global Compact

Addressing adverse human rights impacts connected to product misuse

'Product misuse: the use of a product or service, in whole or in part, for a purpose other than its intended application, which could lead to human rights harm.'⁹⁵

Why should a company care? What are the risks?

'Reputational risks: e.g. brand loss, increased government scrutiny, negative media coverage, anti-company campaigns by NGOs and civil society.'

'Financial risks: e.g. investor divestment, customer boycotts, contract suspension/withdrawal, work stoppages, fines.'

*'Legal risks (civil and criminal): a company could face civil allegations of complicity in inflicting damage resulting from a wrongful act; or criminal allegations in countries that recognise the criminal liability of companies, of complicity in the commission of a human rights offence. Taking "no action" (i.e. an omission), such as failing to employ human rights due diligence, could also lead to criminal or civil allegations because the company "should have known" its actions or omissions would contribute to human rights harm.'*⁹⁶

Opportunities from addressing misuse

The UN Global Compact surveyed business representatives to get an overview of the opportunities that arise from addressing misuse. Information gathered from business representatives reveals that addressing product misuse can provide a competitive edge for:

- 'Branding and marketing opportunities'.
- New business development (in particular if bidding on government contracts that contain human rights clauses).⁹⁷

Summary

As the human security-centred approach to the sale of weapons and ammunition continues to grow in significance, the arms industry has a clear stake in preventing diversion and misuse.⁹⁸ Increased globalisation of operations and focused media coverage can cause stakeholders—governments, investors, business partners, clients and third parties—to react strongly to accusations of human rights violations arising from misuse.⁹⁹ The UN Global Compact's guide to product misuse is relevant to the arms industry because investors, financiers and even freight-forwarders are concerned about the effect on their image and will not invest in, or will divest from, association with industry actors that are complicit in human rights abuses.¹⁰⁰ ATT compliance provides certainty for industry actors and investors by building clear criteria to follow in order to observe ethics, human rights and IHL.

The ATT will provide a framework for the international community to cooperate in addressing diversion and avoiding misuse of conventional arms by terrorists, organised crime and irresponsible end-users (see *Section 2*). The treaty establishes a collaborative approach in combating corruption and locating 'international trafficking routes, illicit brokers, sources of illicit supply, methods of concealment, common points of dispatch or destinations used by organised groups engaged in diversion'.¹⁰¹ This is important for the conventional arms industry as perceptions of complicity in violations of human rights and humanitarian law can affect reputation, attractiveness to investment and sustainability of trade agreements.¹⁰² Hence, sustaining an image as a responsible trader can affect earning power.

The benefits of the ATT for the arms industry lie in creating a more comprehensive regulatory environment, and providing clear risk-assessment criteria to avoid accusations of complicity in human rights abuses and atrocities. Furthermore, illicit and irresponsible transfers negatively affect regional and global economies, adversely affecting the sustainability of ongoing trade and investment agreements.¹⁰³



UN Photo: JC McIlwaine