



# Better Returns in a Better World

## Briefing Paper for the Arms Trade Workshop

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### 1. Introduction

For a great many of the world's poor people, armed violence is directly impeding their chances of development. At least 22 of the 34 countries least likely to achieve the Millennium Development Goals (MDGs) are in the midst of – or emerging from – conflict.<sup>1 2</sup>

Conflict is exacerbated by the irresponsible supply of arms. While all states have a right to self-defence (and responsible supplies of military, security and police equipment can assist a state to provide the security and stability necessary for development), the reality is that arms supplies can also fuel international aggression, internal oppression and the violation of international humanitarian law (IHL).<sup>3</sup> Furthermore, in many developing countries, the procurement of arms is frequently opaque and unaccountable, mired in corruption and often has the effect of diverting resources away from development spending.

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<sup>1</sup> UN Millennium Project (2005) 'Investing in Development: A Practical Plan to Achieve the MDGs'.

<sup>2</sup> Conflict has been identified as one of the four 'traps' – the others are natural resources, being landlocked and bad governance -that keep the world's poorest countries poor and confine the world's 'bottom billion' people to a life of poverty in stagnant or shrinking economies. (See, further, Collier, P. (2007) *The Bottom Billion: Why the poorest countries are failing and what can be done about it*, Oxford: Oxford University Press).

<sup>3</sup> International humanitarian law (IHL) seeks, for humanitarian reasons, to limit the effects of armed conflict. It protects persons who are not, or are no longer, participating in hostilities and restricts the means and methods of warfare. See International Committee of the Red Cross, 'International humanitarian law (IHL) in brief', URL <<http://www.icrc.org>>.

Clearly, the 'arms industry' – or the diverse group of companies producing and supplying military, security, or police equipment – has a potentially important contribution to make in helping ensure that its products and services are sold and used in a responsible manner, although it is important to emphasise that governments are perhaps the most critical actors in these discussions.

Leading European institutional investors have taken a significant role in the movement for a global ban on cluster munitions. However, institutional investors have done relatively little work on other aspects of the arms trade. There are various reasons, most importantly the close relationship with national governments and the reality that a large part of those activities that attract public attention – such as combat and close to combat tasks taken on by Private Military Companies (PMCs), small arms manufacturing and trade, supply of major conventional weapons to recipients under United Nations arms embargoes – are often carried out by either privately held or state-owned companies. The consequence is that the role and responsibilities of the 'arms industry' in furthering peace and stability have received surprisingly little attention in the current debate on corporate responsibility.

While there are a series of important ethical and human rights issues associated with the arms trade, this briefing paper focuses specifically on (a) corruption and the diversion of resources away from development spending, and (b) irresponsible end-use. Oxfam, Insight Investment and Ethix SRI Advisors see tackling these issues as the next critical stage in addressing human rights concerns within the arms industry.

## **2. The Arms Trade: The Development Perspective**

The devastating impact of conflict, armed crime, and all forms of armed violence around the world is apparent for all to see. Armed violence closes schools, paralyses communities, burdens health-care systems, discourages investment and economic activity, and makes lives and livelihoods less secure. Spending on weapons can divert vital funds from public services, such as education and health care. Too often, such spending takes place without accountability and transparency, and involves corrupt payments. Individually and cumulatively, these impacts undermine sustainable development and the achievement of internationally agreed targets such as the MDGs.

### ***2.1 Arms trade and violence***

On average, up to two thousand people are estimated to die every day as a direct result of armed violence.<sup>4</sup> Countless more are injured, bereaved, abused and displaced by state security forces, armed groups, criminal gangs and other

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<sup>4</sup> Geneva Declaration, 'Global Burden of Arms violence', Sept. 2008.

armed individuals.<sup>5</sup> While supplies of military, security and police equipment alone do not *cause* armed violence, extensive research shows how the availability of, and access to, arms can aggravate, intensify, and prolong armed violence. Armed conflicts cannot be sustained without the supply of arms or, where arms are already abundant, without ammunition.<sup>6</sup> While weapons used in situations of armed conflict and armed crime include weapons recirculated from other conflicts, supplies of new weapons – and particularly ammunition – play an important role for the continuation of violence.

This is illustrated by Amnesty International's report 'DRC: Arming the East' which provides an extensive list of highly questionable arms transfers to countries involved in the DRC war.<sup>7</sup> In 2002 and 2003, Rwanda imported millions of rounds of small arms ammunition, grenades, and rocket launchers from surplus stocks in Albania, and there have also been large flows of arms from Eastern Europe to the DRC transitional government and to Uganda. These have unquestionably fuelled the conflict in the DRC – a conflict where, since 1998, an estimated 5.4 million people or eight per cent of the population have died directly due to the conflict and the deadly hunger and humanitarian crisis that it has unleashed.

Another example is provided by the three-week Israeli military offensive in 2008–09 in Gaza, which resulted in more than 1,300 Palestinians killed and over 5,000 injured. Amnesty International has documented the use by the Israel Defense Forces of white phosphorous and other weapons supplied from abroad to carry out serious violations of international humanitarian law (IHL).<sup>8</sup> The Amnesty International research shows that many attacks were disproportionate or indiscriminate, and others were directed at civilians, schools and humanitarian operations. At least 11 different states have supplied arms and related materials to Israel since 2001, with the US being the major supplier; others have served as major transit countries. On the other side, three Israeli civilians were killed and 182 were injured as Hamas and other militant Palestinian groups fired hundreds of rockets in indiscriminate attacks at civilian population centres in southern Israel, constituting serious violations of IHL; the rockets had been smuggled in or made from components sourced from abroad.

## **2.2 Diversion of resources**

While developing countries may need to import arms to meet legitimate self-defence and security needs, spending *beyond those legitimate needs* represents a waste of resources that are often crucially needed for social development. Unlike other areas of trade, arms transfers constitute unproductive expenditure in economic terms. Claims that they create jobs in the recipient state and

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5 Amnesty International, the International Action Network on Small Arms, and Oxfam International (Control Arms Campaign), *Arms Without Borders: Why a globalised trade needs global controls*, Oct. 2006.

6 Hillier, D., Woods, B., *Shattered Lives: the case for tough international arms control*, Amnesty International, and Oxfam International (Control Arms Campaign), 2003.

7 Amnesty International, 'Democratic Republic of Congo, arming the conflict in the DRC East', July 2005.

8 Amnesty International, 'Fuelling Conflict: foreign arms supplies to Israel/Gaza', February 2009.

encourage technology transfer and other economic gains are on the whole unfounded.<sup>9</sup>

The costs of armed violence are both direct and indirect. The *direct costs* – medical costs, military expenditure, the destruction of infrastructure, and the care for displaced people – divert money from more productive uses. The *indirect costs* from lost opportunities are higher, particularly in conflict situations. These indirect costs can include economic activity faltering or grinding to a halt, inflation, unemployment, collapses in public services, and reduced government capacity and control.

Oxfam estimates that Africa loses around \$18bn per year due to wars, civil wars, and insurgencies.<sup>10</sup> This is a massive waste of resources – roughly equivalent to total international aid to Africa from major donors during the same period. Put another way, armed conflict shrinks an African nation's economy by 15 per cent; this is an enormous economic burden – one and a half times average African spending on health and education combined.

Decisions by governments to purchase arms are often made with poor transparency and through structures and procedures that lack civilian oversight. At worst, this encourages corruption and a waste of resources, and at best unnecessary expense and an inability to effectively weigh up the relative merits of spending on arms and the government's other objectives. For example, in Indonesia in 2003, using funds reserved for natural disasters prevention and relief, a \$200m deal for combat aircraft and helicopters was signed by the President without any oversight, sparking allegations of corruption.<sup>11</sup>

### **2.3 Corruption in the arms trade**

Transparency International's Global Bribe Payers Index rates the military sector as one of the top three sectors for bribery and corruption, along with the oil sector and major infrastructure projects. The arms trade is arguably the most corruption-prone of all international businesses. The U.S. Department of Commerce has estimated that corruption in the arms trade accounts for approximately 50% of all corrupt transactions globally, despite the fact that the value of arms traded annually does not exceed 1% of global trade.<sup>12</sup>

Contributing factors are high levels of secrecy in the military sector, the fact that 'national security' requirements can be used to justify nearly any purchase, the high level of complexity of products, contracts and use of sub-contractors, the

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9 J. Brauer (2007) 'Arms Industries, Arms Trade, and Developing Countries,' Handbook of Defense Economics, Elsevier; J. Brauer and J.P. Dunne (2005) 'Arms Trade Offsets and Development', Discussion Paper 0504, University of the West of England, School of Economics.

10 Oxfam (2007) Africa's missing billions: international arms flows and the cost of conflict

11 'Indonesian leader to be investigated over jet purchase', Associated Press, 26 June 2003, available at URL <<http://www.taipetimes.com>>; Perwita, A., 'Security Sector Reform in Indonesia: The case of Indonesia's Defence White Paper 2003', Journal of Security Sector Management, Global Facilitation Network for Security Sector Reform, University of Cranfield, 2004, p.5.

12 'Transparency International (UK), 'Preventing Corruption in the Official Arms Trade', 30 Apr. 2006, Update Note 3.

common use of agents, and the hierarchical nature of defence contracts.<sup>13</sup> Large, one-off deals can be of immense significance to the exporter, who becomes incentivised to do anything possible to secure them, including offering personal rewards to the purchasing decision makers. Many deals are complex and individually tailored so that prices are difficult to compare, making it easy for corrupt payments to be hidden in the overall cost. One example is South Africa, where numerous and persistent allegations of corruption surround a series of contracts originally signed in 1999 between South Africa and a number of major European arms companies.<sup>14</sup>

### 3. The Arms Industry

The 'arms industry' in all leading producer countries has restructured significantly since the end of the Cold War, and is today both more integrated with the civilian sector and more globalized through international co-operation agreements and technology transfers as well as cross-border patterns of ownership through mergers and acquisitions. At the same time, regulation of the arms trade primarily occurs at the national level, with the exception of Europe. An approach to self-regulation, above and beyond national regulation and addressing the specific challenges the industry is facing, is only now emerging. To date, the primary focus of these efforts has been on addressing corruption.

#### 3.1 The arms industry: An overview

The 'arms industry' is not a defined sector in industrial statistics, but cuts across several of these, such as aerospace and defence, electronics, machinery and shipbuilding, with few companies producing exclusively for the military or related governmental markets.<sup>15</sup> The role of IT and electronics companies in particular has increased as civil technology assumes ever greater importance for weapon systems.



Also the privatization and outsourcing of military and support services has drawn new kinds of suppliers into military contracting.<sup>16</sup>

Ownership of the largest producers of military equipment has shifted markedly over the past two decades, in particular in Western Europe, where previously state-owned companies have been transformed into stock-listed companies with limited state ownership. Furthermore, as a result of the growing role of primarily civilian-oriented companies as sub-contractors to the

13 CM-CIC Securities, 'Business as Usual: A Financial and Extra-financial Analysis of the Aerospace & Defence Industry', in UNEP Finance Initiative, Show Me The Money: Linking Environmental, Social and Governance Issues to Company Value, 2006.

14 Oxfam, Shooting down the MDGs, Oxfam Briefing Paper 2008.

15 Sköns E and Weidacher R., (1999) 'Economics of arms production' in Encyclopedia of Violence, Peace, and Conflict, Volume 1, Academic Press, p.133-142.

16 Stockholm International Peace Research Institute (SIPRI), 'Trends in arms production', URL <<http://www.sipri.org/contents/milap/milex/aprod/trends.html>>.

military sector, the importance of stock-listed companies overall within the military market appears to have increased. Despite the changes in Western Europe, much of the arms industry remains largely state-owned in major producing countries such as China, Russia, India, and Pakistan.

Illegal arms supplies – in violation of either national regulations or United Nations arms embargoes – are often carried out by either privately held or state-owned companies. However, listed companies may have some responsibility; as the production of military equipment has become increasingly ‘globalized’, weapons are assembled from components sourced from companies (listed and unlisted) around the world. A case in point is India’s Advanced Light Helicopter (ALH) (see above), a number of which were reportedly included in a proposed arms transfer between India and Burma.<sup>17</sup>

### ***3.2 Lack of international regulation***

The key distinctive feature of the ‘arms industry’ is the role played by domestic governments as customers and regulators. Companies have to seek the approval of national authorities to export military-specific equipment. In spite of the increasing globalization of the production of military, security, or police equipment, international law plays a very limited role in the regulation of the industry. There are no international conventions prohibiting or restricting transfers of conventional weapons and a comprehensive international approach seeking to address existing loopholes, is only just developing.

The only global arms controls are arms embargoes on specific states or end-users imposed by the United Nations Security Council through resolutions adopted under the authority of Chapter VII, Article 41, of the United Nations Charter. It is worth noting that UN arms embargoes have been criticized as having a limited impact on reducing arms flows or improving the behaviour of targeted entities.

Regional bodies such as the European Union can also impose arms embargoes and some regions have developed their own regulatory framework on arms transfers. Europe has developed a broader regional approach to arms exports through the European Code of Conduct on Arms Exports, adopted in 1998 with the aim of achieving greater harmonization of national arms export regulations. In December 2008, a Council Common Position made the Code legally-binding. Among the eight criteria covered, two are of particular relevance for the goals of poverty alleviation and development: ‘Respect for human rights in the country of final destination as well as respect by that country of international humanitarian law’; and ‘Compatibility of the exports of the military technology or equipment with the technical and economic capacity of the recipient country [...]’.<sup>18</sup>

The principles on which the European Code of Conduct on Arms Exports are based are reflected in the initiative for a legally binding and universal Arms Trade Treaty (ATT). The ATT initiative was inspired by a group of Nobel Peace Laureates and gathered wide support through the Control Arms Campaign, a

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17 Amnesty International UK and Saferworld, Indian helicopters for Burma: making a mockery of embargoes?, May 2007.

18 Official Journal of the European Union, Council Common Position 2008/944/CFSP of 8 December 2008 defining common rules governing control of exports of military technology and equipment.

joint campaign between Oxfam, Amnesty International and IANSA (International Action Network on Small Arms). It was later taken up by governments and, in 2006, brought within the UN framework. Discussions are currently ongoing within the UN on the treaty's potential content – the earliest a treaty might emerge would be 2011.<sup>19</sup>

### **3.3 The 'arms industry' and corporate responsibility**

Relatively little attention has been paid in the general debate on corporate responsibility to the challenges specific to the 'arms industry', the most significant of which relate to:

- Its products, specifically its involvement in illegal weapons or weapons deemed particularly controversial;
- Its sales processes, in particular unaccountable arms procurement decisions that lead to the diversion of resources away from development spending and a history of involvement in corruption;
- Its clients and the potential for the irresponsible end-use of military, security or police equipment.

The most notable exception to the lack of attention on these issues is the short mention of the 'arms industry' within two widely-used reference works, the United Nations draft *Norms on the Responsibilities of Transnational Corporations and Other Business Enterprises with regard to Human Rights* (2003) and *Human Rights Translated* (2008).<sup>20</sup> Both address the production of illegal weapons as well as the irresponsible supply of weapons (i.e. the supply of weapons where they might fuel poverty, conflict or human rights abuses) and call on companies to 'conduct risk assessments to avoid sales of weapons systems and dual-use products/ technologies to governments known to perpetrate gross human rights violations against their own people or those in neighbouring countries'.

The core of the 'arms industry' – or the group of leading global suppliers of military, security, or police equipment and services<sup>21</sup> – is only just beginning to discuss corporate responsibility. One particularly interesting development is the 2008 report by the Woolf Committee, appointed by the Board of Directors of Europe's largest arms producer, BAE Systems plc, to review its ethical policies and processes.<sup>22</sup> The report maps the ethical challenges and reputational risk

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19 Holtom, P, Wezeman, S., Appendix 10C. Towards an arms trade treaty?, SIPRI Yearbook 2007s.

20 United Nations Sub-Commission on the Promotion and Protection of Human Rights, Commentary on the Norms on the Responsibilities of Transnational Corporations and Other Business Enterprises with regard to Human Rights, UN Doc. E/CN.4/Sub.2/2003/38/Rev.2, 2003; Castan Centre for Human Rights Law, International Business Leaders Forum, and Office of the United Nations High Commissioner for Human Rights, *Human Rights Translated: A Business Reference Guide*, 2008, URL <[http://www.unglobalcompact.org/docs/news\\_events/8.1/human\\_rights\\_translated.pdf](http://www.unglobalcompact.org/docs/news_events/8.1/human_rights_translated.pdf)>.

21 Stockholm International Peace Research Institute (SIPRI) annually compiles a list of the world's 100 largest arms-producing companies (excluding Chinese companies), ranked by their arms sales. See SIPRI, URL <<http://www.sipri.org/contents/milap/milex/aprod/>>.

22 Woolf Committee, 'Ethical business conduct in BAE Systems plc – the way forward', May 2008, URL <[http://217.69.43.26/woolf/Woolf\\_report\\_2008.pdf](http://217.69.43.26/woolf/Woolf_report_2008.pdf)>. BAE Systems plc, 'Woolf Committee Report', URL <<http://ir.baesystems.com/investors/woolf/>>.

faced by 'global defence companies' and proposes a set of measures for addressing them proactively.

It is worth emphasizing that, in the wake of the campaign for a global ban of cluster munitions, some leading Western arms producers have significantly shifted their position towards acknowledging some responsibility for avoiding involvement in weapons prohibited under existing international conventions – even when their home government has not committed itself to a ban. Few companies overall, however, have openly communicated their position.

The industry has also made some efforts to reduce/eliminate bribery and corruption.<sup>23</sup> Three initiatives worth mentioning in this regard are the US Defense Industry Initiative on Business Ethics and Conduct, the Transparency International-led project on Preventing Corruption in Official Arms Trade and the Common Industry Standards for European Aerospace and Defence (see Box below). Despite increased scrutiny and the apparent cooperation on the part of some of the leading companies in the sector, it is not possible to assess whether these actions have reduced corruption in arms procurement as the lack of transparency continues to impede verification.

#### **Anti-corruption initiatives**

The Defense Industry Initiative on Business Ethics and Conduct (DII) was established in the United States in 1986, partly in response to the findings of a government appointed commission investigating arms procurement processes and practices. The commission found that public confidence in the 'arms industry' was low as a result of reported instances of waste, fraud, and abuse of power. The DII commits signatories to self-regulation and monitoring of compliance with U.S. arms procurement law. By late 2007, 80 companies had signed the initiative.<sup>24</sup>

The UK Chapter of Transparency International's 'Defence Against Corruption' (DAC) programme seeks to address corruption in the defence and national security sectors. Transparency International works with governments, defence companies, multilateral organisations and civil society to prevent corruption in defence, and to build anti-corruption capacity and integrity in defence establishments across the world.<sup>25</sup>

In 2007, the AeroSpace and Defence Industries Association of Europe (ASD) adopted a set of Common Industry Standards (CIS) for European Aerospace and Defence whose aim is to 'to promote and enhance integrity practices amongst its member companies taking into consideration the European context'.<sup>26</sup>

The issue of responsibility for the end-use of legally supplied equipment and services, however, is near to absent from the already limited debate about corporate responsibility within the industry. While not comprehensively addressed, the issue is touched upon in the above mentioned Woolf Committee report. The report emphasizes the importance of companies balancing government arms export authorizations against ethical standards and reputational risks and of making such procedures and decisions public: 'A global defence company should have a global corporate policy and process for

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23 Surry, E., Transparency in the Arms Industry, Stockholm International Peace Research Institute (SIPRI), Policy Paper No. 12, Jan. 2006.

24 The Defense Industry Initiative on Business Ethics and Conduct, URL <<http://www.dii.org/>>.

25 Transparency International UK, 'Defence against Corruption', URL <<http://www.defenceagainstcorruption.org/>>.

26 AeroSpace and Defence Industries Association of Europe (ASD), 'Common Industry Standards for European Aerospace and Defence', April 2007, URL <<http://www.asd-europe.org/Objects/2/Files/WEB%20Common%20Industry%20Standards.pdf>>.

identifying (and if necessary rejecting) possible countries for export potential that explicitly includes assessment of ethical and reputational risk factors that go beyond whether an export license is likely to be granted.’<sup>27</sup>

### **3.4 Oxfam’s view**

Oxfam’s view is that the defence industry falls short of adequately addressing its corporate responsibility duties. It is an industry which, in comparison with other sectors, is in its infancy in addressing and managing human rights risks. Oxfam believes that the industry can significantly contribute to the achievement of the MDGs and the reduction of armed conflict by putting in place and ensuring compliance with the following requirements:

- Companies should not supply conventional arms or ammunition where there is a substantial risk that they will:
  - be used or are likely to be used for serious violations of international human rights law or international humanitarian law.
  - have an impact that would undermine sustainable development or involve serious corruption.
  - provoke or exacerbate armed conflict in violation of obligations under the UN Charter and existing treaties.
  - contribute to pervasive violent crime or to terrorist acts.
  - be diverted for any one of the above outcomes.
- Companies should commit to rigorous contract-specific no-bribery warranties. These should be reinforced by evidence that companies have in place sufficient internal compliance systems capable of detecting corruption-risk and preventing the payment of bribes. This should apply to defence companies, but also to companies that supply components to the sector. Companies investing in third-party arms manufacturers should ensure their investee companies comply with anti-corruption standards.
- Companies should collaborate on an International Defence Industry Anti-Corruption Initiative and contribute to the development of a common agreement on a global defence industry anti-corruption framework.
- Non-defence companies such as IT and electronics companies when providing components and/or equipment to defence companies should endorse the above policies and make them explicit in their contracts.
- When investing in defence-related companies, companies should ensure that their same normative standards are complied with.
- To assure that the above policies are complied with, companies should develop and implement adequate systems and internal controls to monitor these policies and sensitive aspects of contract compliance.
- Companies should actively support the ATT.

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<sup>27</sup> Woolf Committee, see above, p. 23.

- Companies should make their policies on these issues publicly available, and should report annually on performance against these policies as well as on any stakeholder engagement that has been conducted in relation to these issues. Companies should also state who within the organisation is responsible for the implementation of these policies.

#### **4. The Role of Investors**

Research has shown that, overall, mismanagement of environmental, social and governance (ESG) issues can decrease company value – and thereby investor value. However, that this general proposition may apply also to the ‘arms industry’ has been questioned. A 2006 study by CM-CIC Securities found that ESG factors have no material impact on companies with a strong dependency on military contracts. With regard to corruption, the study concluded that companies with strong controls on bribery and corruption may be at a competitive disadvantage because many purchasers accept the payment of bribes (or similar forms of payment) as a normal part of doing business. Given their close relationship with national governments, companies will only value ESG factors to the extent their governments do.<sup>28</sup>

While the core of the ‘arms industry’ is not subject to consumer pressure and only marginally to reputational risks, investors are facing increasing pressure from civil society organisations to address human rights concerns relating to the arms industry. Leading European institutional investors have been attributed and assumed a significant role in the movement for a global ban on cluster munitions. This raises the question of whether investors should also address the equally important issue of irresponsible supplies of weapons and other military equipment?

##### **4.1 What have investors done?**

While the arms industry’ has been a traditional concern of ‘ethical’ investors (i.e. those that choose not to invest in activities or sectors that they do not wish to support)<sup>29</sup>, mainstream investors have paid much less attention to the human rights and corporate responsibility issues associated with the industry in their investment research or engagement activities.

Perhaps the most significant efforts have related to controversial weapons. Over the past five years, institutional investors have gradually responded to mounting civil society campaigns for the international prohibition of cluster munitions, by introducing exclusionary criteria. While the focus has primarily been on cluster munitions, the coverage commonly extends to weapons explicitly prohibited under international conventions (see Box) as well as, occasionally, to nuclear weapons and, in rare cases, depleted uranium ammunition.

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28 CM-CIC Securities, Note 13.

29 According to the European Social Investment Forum (Eurosif), weapons screening is the most frequently used simple exclusion applied in socially responsible investments (SRI), with around 25% of the total SRI assets under management having such a screen. Data are for 2007. Eurosif, European SRI Study 2008, URL <[http://www.eurosif.org/publications/sri\\_studies](http://www.eurosif.org/publications/sri_studies)>.

### **Illegal and 'particularly controversial' weapons**

International Humanitarian Law (IHL) prohibits the use of weapons that have indiscriminate effects and are incapable of distinguishing between civilian and military targets. Illegal weapons, whose production and use is prohibited according to existing international conventions, are the following:

**Conventional weapons:** blinding laser weapons, non-detectable fragments, anti-personnel mines and cluster munitions\*.

**Weapons of Mass Destruction:** chemical weapons and biological weapons.

The involvement today of listed companies in the production and trade of illegal and 'particularly controversial' weapons in countries that are not parties to the conventions is relatively minor and further decreasing (cluster munitions).<sup>30</sup>

\* The Convention on Cluster Munitions has been signed by close to 100 states, but has not yet entered into force.

There does appear to be growing interest within the investment community in investigating corporate involvement in irresponsible supply of weapons and other military equipment. For example, in response to growing interest from investors, in 2005, Ethix SRI Advisors extended its widely used Norm-Based Screening service to include irresponsible supplies of military, security, or police equipment. Within this approach investors have addressed supplies of equipment to, among others, Burma, Israel, Sudan and Zimbabwe and used in violation of international humanitarian law.

Another example, also from Scandinavia, is the decision in late 2008 by the Norwegian Ministry of Finance to introduce an amendment to the ethical guidelines for the Norwegian Government Pension Fund: 'The amendment implies that investments in companies which sell arms or military equipment to states which are on the list of countries whose government bonds are not investable, are to be avoided.' The new criterion was first applied to a Chinese company, Dongfeng Motor Group Co., Ltd. found to be involved through a subsidiary in the sale of military trucks to Burma.<sup>31</sup>

#### **4.2 Lack of transparency: barrier to action?**

As discussed above, the international arms trade is highly opaque. There is limited publicly available information on the links between specific products (and suppliers) the end-use of military, security, or police applications. Where information is available it can be challenging to distinguish between responsible and irresponsible use. This state of affairs has been highlighted in the above mentioned Woolf report.

The main sustainability initiatives advocating corporate disclosure, such as the Global Reporting Initiative, were not drawn up with the military sector in mind, and companies seldom feel compelled to voluntarily disclose information on the destination of their products.<sup>32</sup> This constitutes a major barrier to action for

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30 Ethix SRI Advisors, 'Declining corporate involvement in cluster munitions', 29 Aug. 2008, URL <<http://www.ethix.se/nyheter/include2.asp?id=147>>.

31 Council on Ethics, Norwegian Government Pension Fund – Global, 'Recommendation of November 14, 2008, on exclusion of the company Dongfeng Motor Group Co. Ltd'.

32 Surry, E., Transparency in the Arms Industry, Stockholm International Peace Research Institute (SIPRI), Policy Paper No. 12, Jan. 2006.

investors interested in placing the 'arms industry' under greater scrutiny with regard to the impact of the supply of military, security, or police equipment on human rights.

It is interesting to note, however, that the shift in ownership of major arms-producing companies from states to stock markets and the growing involvement of civilian producers in aspects of the defence sector may increase calls for transparency from shareholders (both to enable them to properly value these companies and also because of the need for shareholders to respond to pressure from other stakeholders about how they discharge their responsibilities in relation to the companies in which they are invested).

## **5. Questions for the workshop**

### ***5.1 Corruption***

- Are the normative expectations of companies clear?
- Have investors engaged with companies on the issue of bribery and corruption? Has this been effective? Have investors supported and/or engaged in multi-stakeholder initiatives such as the DII in the US or TI programme 'Defence Against Corruption'?
- Do investors take account of bribery and corruption in their views/analysis of companies?

### ***5.2 Irresponsible Arms Supply***

- Do investors take account of irresponsible supplies in their views/analysis of companies?
- Have investors engaged with companies on this issue?
- To what extent is the absence of an agreed normative framework an issue for investors seeking to engage with companies?
- What is the appetite of investors for supporting the Arms Trade Treaty?

## 6. Further Reading

We suggest that those interested in finding out more about the issues of corruption in arms procurement and irresponsible arms supplies visit the following websites:

Civil Society:

[www.oxfam.org.uk](http://www.oxfam.org.uk)

[www.controlarms.org](http://www.controlarms.org)

[www.transparency.org](http://www.transparency.org) - [www.defenceagainstcorruption.org](http://www.defenceagainstcorruption.org)

[www.sipri.org](http://www.sipri.org)

Industry:

[www.dii.org](http://www.dii.org)

[www.the-dma.org.uk](http://www.the-dma.org.uk)

[www.soff.se](http://www.soff.se)

Investors and the Arms Industry

[www.ethix.se](http://www.ethix.se) – [reinilde.weidacher@ethix.se](mailto:reinilde.weidacher@ethix.se)

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Special acknowledgements to Sam Perlo-Freeman and Mark Pyman for their valuable comments.

For more information on the Better Returns in a Better World project, see <http://www.oxfam.org.uk/resources/issues/privatesector/investment.html>

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- Rory Sullivan (Insight Investment): [Rory.Sullivan@insightinvestment.com](mailto:Rory.Sullivan@insightinvestment.com)

May, 2009