Engaging the Private Sector in Nonproliferation: Reflections from Practitioners

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Abstract

This paper examines the role of the private sector and its efforts to facilitate continued engagement to support nonproliferation. This includes examining the efforts of one academically-based group established by the authors and international regimes such as the Nuclear Suppliers Group. The paper also explores what further measures are required for the private sector to more robustly contribute to nonproliferation. These further measures focus on supply chain issues. The paper concludes that while much progress has been made in engaging the private sector in nonproliferation, much work remains if future proliferation episodes are to be prevented.

Keywords

Strategic trade, industry outreach, nonproliferation, compliance, supply chain

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Introduction

Since the later 1970s, there has been an increasing recognition of the role that industry plays as the ‘first line of defense’ in countering proliferation of goods and materials related to weapons of mass destruction (WMD). At least two of the export control regimes have adopted measures intended to facilitate the adoption of good practices in industry. At least two industry-led movements are also underway. Numerous companies have also adopted internal compliance programs (ICPs). Despite this progress, the potential for companies to be involved in proliferation persists. Looking to the future, it is not clear that past involvement of companies ranging in type from small and medium-sized to state-owned enterprises in proliferation will not continue. Looking to the future, therefore, it is necessary to consider what is expected of the private sector and what further steps must be undertaken to prevent private sector involvement in proliferation.

The purpose of this paper is to examine these issues. The paper begins by exploring what expectations exist around the role of the private sector in countering proliferation. This includes looking at the nature and content of good practice guidelines as presented by numerous organizations, including governments and certain export control regimes. The paper then considers efforts to engage the private sector in countering proliferation. This includes efforts of governments, civil society, and industry itself. Third, the paper examines the gaps in private sector implementation of nonproliferation controls. These are identified as a) issues related to compliance and b) issues related to the supply chain.

The Role of the Private Sector

Identifying proliferation-related procurement can be a hard task for private sector entities. Iran, for example, developed sophisticated methods to evade United Nations and unilateral sanctions on its nuclear and ballistic missile programs, including changing names of companies in the procurement networks, using front companies in states bordering Iran and further afield, mislabeling equipment, procuring sub-optimal but non-sanctioned substitute equipment, and trading through third countries. Nevertheless, there is plenty of information about Iran’s and DPRK’s illicit procurement activities available from a variety of public sources, including reports of UN Sanctions Panels and studies published by Project Alpha, the International for Science and International Security (ISIS), and other organizations.


The private sector’s role in countering proliferation that goes beyond the legal obligations of states to comply with international sanctions or other controls that began in the late 1970s have been exemplified in many cases. One example is in 1979 when the European company Emerson realized that its inverters were likely destined for a nuclear end use in Pakistan, halted exports to Pakistan, and brought the fact to the attention of British authorities. The UK, in turn, reached out to other states that were potential suppliers of inverters. The purpose was to dissuade another state from supplying the goods that the British firm had opted not to supply (i.e., to prevent ‘undercutting’ as it is recognized today). Pakistan thus began to utilize covert procurement techniques in the late 1970s.

Proliferation has continued through this modality ever since. Pakistan, Iraq, Iran, North Korea, and others have all utilized covert procurement of dual-use goods through non-state actors to further their nuclear and missile programs.

Defining the role of the private sector in nonproliferation is nonetheless not straightforward. Under the international system as it exists today, for example, the basic role of the private sector is to be compliant with the laws of the jurisdictions in which they operate. It is, according to international law, the responsibility of the state to decide how to implement its commitments, including with regards to nonproliferation. It is with this in mind that United Nations Security Council Resolution 1540 calls upon states to adopt and enforce appropriate and effective laws and to find ways to ‘work with and inform the private sector.’

From another perspective, companies might be expected to act within their own self-interest even if this differs positively or negatively from the laws of the jurisdictions in which they operate. It is in this context that factors such as reputation become key. Factors beyond laws can influence the actions of companies.

A third perspective is that broader factors might act upon the behavior of companies. It could be, for example, that moral considerations affect the decision-making calculus of companies—perhaps principally through the actions and decisions of specific employees.

**Engaging the Private Sector**

The authors of this paper, when formerly working as UK Government counter-proliferation practitioners, independently concluded that the Government could make better use of the capabilities of and information held by the private sector. Although several UK Government Departments and Agencies implemented outreach programs to manufacturers and other relevant companies, these tended to focus more on export control legislation and good implementation practices. However, companies that manufacture or transport goods and materials required by illicit proliferation programs may possess actionable information about clandestine procurement networks, and effective mechanisms need to be set up to ensure that such information is shared with law enforcement or other relevant agencies so that action can be taken to combat proliferation.

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Project Alpha within the Centre for Science and Security Studies, King’s College, London, in 2011, was set up in order to encourage and support private sector efforts to detect and deter proliferation, and thus support the Government’s strategic goal to reduce the threat to the UK from proliferation of WMD. The Project sought to improve the implementation by the private sector of controls to counter illicit trade by conducting industry outreach in the UK in partnership with the Government’s Export Control Organization and other relevant Departments, by providing services such as free e-learning, training and consultancy, and in particular in China by conducting industry engagement in partnership with Chinese authorities. Project Alpha maintains a ‘Partners Initiative’ linked to the Nuclear Suppliers Group (NSG) good practice guidance to encourage companies to be proactive in preventing proliferation-related trade.

In order to expand knowledge within Government and the private sector of the practices and methods used by proliferation networks, Project Alpha also researches and publishes examples of illicit trade, partly based on information provided by the private sector in the UK and elsewhere.

While it is undoubtedly true that no respectable private sector entity would wish to be involved in proliferation procurement, because such procurement is hard to detect, and because the risks might seem to be low, companies may be resistant to investing necessary resources in adequate compliance programs. It is the responsibility of governments to build the narrative to encourage them to do so. Efforts to engage the private sector ideally should build upon one or more of the several factors that can be used to induce companies to act in specific ways, but typically, the approaches taken by many governments mainly relate to the adoption and enforcement of laws, combined with awareness raising and training with the aim of inducing compliance. For example, many, or perhaps most governments that implement export controls are thought to have some form of outreach program in place.

In recent years, there have also been a variety of efforts to encourage and foster companies to incorporate export control provisions into their corporate social responsibility programs. For example, all members except Russia of the Nuclear Suppliers Group endorsed the “Good Practice Guidelines for Corporate Social Responsibility” adopted in 2013. These Guidelines, reproduced in Annex 1, build upon recommendations for private sector implementation of counter-proliferation standards earlier proposed by one of the authors of the present paper.

There has perhaps been a less systematic effort to build upon the expanded idea that individual employees can be champions for nonproliferation within a company—at least as instigated by governments. In a number of countries, bottom-up and civil society-led efforts have created communities of compliance individuals that meet to discuss export control and nonproliferation issues. Examples known to the authors include, in addition to the Project Alpha ‘partners’ initiative, the network created by the James Martin Center for Nonproliferation Studies, Middlesbury

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7 Project Alpha was conceived by Dr. Jonathan Brewer following his retirement from government service. Dr Brewer then joined the UN Panel on Iran in New York, and Ian Stewart was seconded from the British Ministry of Defense to King’s College London to set up and run the project.


Institute for International Studies at Monterrey, (CNS), and the networks of individuals certified by the Center for Information on Security Trade Controls (CISTEC), in Japan. In this context, it can be considered that there is an overlap between professionalization of compliance officials and the creation of industry champions. This overlap is not necessarily complete, however. The authors are aware of suggestions that a mechanism be created for whistle blowers to alert appropriate parties over concerns about a company’s actions with regards to nonproliferation, for example. Evidently, potential whistle blowers might not be limited to compliance officials.

A variety of requirements exist that are important in the context of the implementation of each of these measures in practice. They include the preparation and publication of guidance on export controls, internal compliance programs, product rating programs and so on. They also include the provision of training by governments, academia, and commercial service providers.

Unfulfilled Potential

Despite the variety of tools and levers that are available to engage private enterprises in nonproliferation, there are a variety of limitations to the approaches, which mean that the private sector is not yet fully functioning in its potential role as the front line of defense in countering proliferation. The principal reason for this relates to the nature of proliferation and commerce. While proliferators might still submit inquiries to manufacturers of sensitive goods directly, improving implementation of export controls in major firms has resulted in an offset activity. Proliferators instead often use either front companies or middlemen when seeking to acquire sensitive goods. A variety of cases highlight this point, including networks set up by the procurement agent Li Fang Wei in support of Iran’s illicit programs, separate Iranian procurement networks detected by Rakon, and networks described by the UN Sanctions Panel on the DPRK.¹⁰

Another trend is for proliferators to import parts, materials and components that are not listed in control regimes such as the NSG or Missile Technology Control Regime (MTCR) and thus are not automatically subject to export controls. Investigations carried out by the UN Sanctions Panel on Iran at one point demonstrate this pattern: of thirty cases of goods or materials interdicted on the basis of information that they were intended for programs prohibited under UN sanctions on Iran, only ten percent were of controlled items.¹¹ There are likely a number of reasons for this: with the constant improvement of technology globally, the number of items which can realistically be controlled by export control authorities, and thus included in the NSG or MTCR control lists, is decreasing; the manufacturing base for most controlled items is very small, whereas the manufacturing base for materials and equipment might be larger, or that illicit proliferation programs may be content to build a low-quality facility rather than a facility that meets Western industrial standards. Companies producing non-controlled items will generally be less sensitized to export control issues.


The problem is that the current levers, as described in the previous section, are so far still proving insufficient to compel companies to address the supply-chain proliferation risk. It is helpful to examine each in turn.

**National Compliance Requirements**

A basic feature of the international system as it exists today is that it is for each government to implement and enforce controls within its own jurisdiction. For example, the authors’ impression is that Chinese authorities have tended to focus efforts on State Owned Enterprises while acknowledging the need for better engagement with Small and Medium-sized Enterprises. Furthermore, although bodies such as the World Customs Organization have emphasized the need for enhanced implementation of export controls, there are as yet no internationally recognized standards for implementation. Procurement networks are able to exploit such weaknesses.

With few exceptions, although governments may require their exporters to carry out end-user checks in some form, generally they do not have an ability to conduct extraterritorial enforcement. The effect of this is that governments focus on controls at the point of export. Some countries such as the U.S do conduct some pre- and post-shipment verification to validate the bona fides of the end user. These measures can prevent transfers to front companies. However, they are poorly suited to ensuring that goods are not later diverted. Substantial onward transfers of proliferation-sensitive goods have taken place as a result of these limitations.

**Corporate Social Responsibility and Industry Champions**

In principle, corporate social responsibility and internal compliance programs could allow companies to go beyond the limitations of export compliance as set out above. However, there are few signs that nonproliferation principles are being systematically embedded into CSR in a widespread way. Similarly, beyond appointment of export compliance officials, there are few signs that compliance champions are emerging to address supply chain issues other than in a handful of cases. For example, U.S firm MKS instruments put in place a supply-chain compliance system for vacuum equipment that appears to be relatively robust. The ‘controlled delivery model’ as introduced by MKS was suited to the nature of the vacuum gauge market. However, it is a model that might not be well-suited to other sectors as it required the elimination of distributors from the supply chain.

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12 Conclusions reached following Project Alpha/China Arms Control and Disarmament Association Industry Outreach workshops in Qingdao, China in February 2012 and Dalian, China in November 2012.


Towards a Supply Chain Approach to Nonproliferation

If the limitations of the current approach to export controls are apparent, perhaps so too is the main remedy. There is a need to address proliferation risks in the supply chain. A satisfactory supply chain solution might be considered to start with adoption by companies involved with corporate best practices or a variation of them. In practice, this would involve an expanded use of measures such as pre- and post-shipment verification. Development of this concept requires engagement with, amongst other bodies, trade and professional associations, many of which are already grappling with issues relating to harmonization of standards and documentation within the supply chain.

However, it might also require additional measures. One such measure is the concept of import notification, where exporters (or exporting states) inform the authorities of recipient countries that goods have been or will be exported to a company so that the receiving authority can conduct industry outreach or end use/end-user checks.

Another important supply-chain lever relates to the service sectors, such as the finance, freight and shipping industry. Companies operating in service sectors have access to a variety of information that could be used for supply chain compliance and due diligence activities. The Secretary General of the international freight-forwarders association, FIATA, noted in November 2014, “Diligence exercised by logistics companies can significantly reduce the burden on governments that are already stretched thin.”

However, presently, the compliance approaches of such firms are generally limited to ensuring that transactions to a party are not on a sanctioned entity list. Going beyond this will require in particular adequate information from national authorities about prohibited WMD activities. But new tools are also becoming available, for example, Project Alpha has recently created a key word list linked to the control lists of the export control regimes so that such firms can screen transactions for the keywords actually used by industry- as opposed to the terms used in the control list, which are generally of low value for transaction screening purposes. Commercial organizations also offer vessel tracking tools that integrate entity screening systems. It appears that such tools are increasingly being used by the financial services sector to track the movement of vessels. The authors are also aware of companies that are working to make it possible for shipping firms and banks to know whether items being transacted are subject to control or prohibition.

There are also more straightforward measures that can be taken. For example, all companies should ensure that their business partners have in place a trade compliance program. Furthermore, as pointed out by the UN Sanctions Panel on Iran following its investigations, multi-national companies should ensure that compliance standards enforced in their domestic jurisdiction


17 For example, see Polestar: PurpleTRAC website, <http://purpletrac.polestarglobal.com/overview>. 
are equally well-implemented by subsidiaries overseas.\textsuperscript{18} There is presently no internationally recognized standard for an internal compliance program in the trade compliance field, but in the European Union, some consideration has been given to the question of linking trade compliance to the Authorized Economic Operator (AEO) framework.\textsuperscript{19}

More generally, and as set out above, there is a need to integrate supply chain considerations into both national and company levels’ implementation of export control measures. In terms of national implementation, governments must take supply chain issues into account both at the time of considering a license and during dialogue with companies. This might also be an issue that could be taken up systematically by the UNSCR 1540 committee as well as the export control regimes.

The fact that illicit trade involving non-state actors continues to be a problem nearly four decades after the first cases were detected might suggest that the current system of export control governance is poorly suited to bringing about such supply-chain approaches. In this context, it is perhaps non-governmental efforts that are best placed to conceptualize and develop solutions.

### Conclusions

The general structure of international law and the nonproliferation regime places primacy upon the state. The state is held to account for its own actions and for the actions of actors upon its territory. Nonetheless, the nature of proliferation today often means that it is the private sector or enterprise that is the source of proliferation rather than the state itself. It is for this reason that states are required under resolution 1540 to find appropriate ways to work with and inform industry. Indeed, for proliferation to be countered, it is not sufficient for industry to be aware of its legal obligations. Partnerships between government and industry are required so that both may leverage each other’s respective information and resources.

Governments tend to have a greater appreciation of the problem of proliferation. Governments will have a view about which states pose a proliferation concern. Governments might also have intelligence information about specific entities or activities that could be proliferation-related. Industry, on the other hand, tends to have less of an appreciation of the nature of proliferation. Nonetheless, the technical and business information held by industry can often be essential in nonproliferation efforts.

More needs to be done to leverage the support that the private sector can provide to governments’ counter-proliferation efforts. One reason that Project Alpha was created was to facilitate this. As other organizations including CNS, CISTEC, and the Chinese Academy of International Trade and Economic Cooperation (CAITEC), have demonstrated, non-governmental organizations can be important facilitators in this regard. In order to detect and counter the next proliferator as well as to deal with current proliferators, a key priority for the nonproliferation community should be to encourage and foster the activities of the non-governmental sector.


\textsuperscript{19} The authorized economic framework is principally a Customs compliance standard. Many governments have created AEO Programs under the WCO’s SAFE framework. There is mutual recognition of the standard between some governments.

The following practices are authored by the Government of the United Kingdom of Great Britain and Northern Ireland with the help and support of the Governments of Australia, Canada, Finland, Germany, Japan and the United States of America. These practices recognize that proliferation of Weapons of Mass Destruction has the potential to seriously threaten international peace and security and undermine economic, commercial and social development; and recognize the important role that the diverse commercial sector (exporters, shippers, freight-forwarders, brokers and indeed all those involved in commercial or financial transactions) can play in assisting multilateral efforts in nonproliferation of Weapons of Mass Destruction. These practices are not legally binding—they are intended to provide a platform from which individual companies may adopt internal practices and are not exhaustive. These practices complement existing legal obligations to comply with national law.

Practices

It is suggested that companies should seek to:

1.0 implement internal systems to ensure due-diligence checks are carried out on potential customers and business partners and the goods, software and technology that they wish to acquire, utilizing public information such as early warning lists, red-flag checklists and questionnaires provided by the United Nations, States and other parties with an interest in supporting the multilateral nonproliferation effort, and to consult with the relevant government authorities as necessary;

2.0 monitor, collate and vet inquiries within the scope of due diligence, relating to the acquisition of proliferation sensitive goods, software and technology;

3.0 consult government export control authorities before having any dealings with entities identified as being of proliferation concern either from public sources, from corporate monitoring systems or from contact with relevant competent authorities in states themselves;

4.0 implement best efforts to share information about illicit attempts to procure items for Weapons of Mass Destruction programs with security and other relevant agencies in the State where they are established and with business partners and others in instances where the State judges that broader publicity would be appropriate;

5.0 promote the adoption of due diligence and information sharing within the supply chain and with other business partners within the boundaries of legitimate protection of business and company information;

6.0 incorporate nonproliferation measures and export control compliance into existing Corporate Social responsibility statements;
7.0 encourage relevant industry-wide trade and professional bodies to recognize the importance of supporting and encouraging the nonproliferation effort and the measures set out herein; and

8.0 foster an open and transparent relationship with appropriate government and regulatory authorities.

Adoption and promotion of these practices will enhance active commercial sector support for nonproliferation by reducing the risk of inadvertent supply of items to illicit programs.