Statement

of

Robert J. Lieberman
Assistant Inspector General for Auditing

Hearing On

Export Licensing Processes for Dual-Use Commodities

May 26, 2000

Mr. Chairman and Members of the Committee:

I appreciate the opportunity to discuss the Federal Government's export licensing processes for militarily sensitive, dual-use commodities and technology. As you know, in response to a request from this Committee in August 1998, Inspector General teams from the Commerce, Defense, Energy, State, and Treasury Departments and the Central Intelligence Agency reviewed a series of issues related to export controls for both dual-use items and munitions. The results were contained in an interagency report and six individual agency reports issued in May and June 1999, and were the subject of your hearing on June 23, 1999. Some of those results are pertinent to the ongoing dialogue on renewing the Export Administration Act of 1979, so I will recap the principal findings on dual-use items as a prelude to commenting on factors that merit consideration in terms of new export control legislation.

Dual-use commodities are goods and technologies with both military and commercial applications. The current dual-use export licensing process was established by the Export Administration Act of 1979, as amended. Although the Act expired in 1994, its provisions are continued by Executive Orders 12924, "Continuation of Export Control Regulations," and 12981, "Administration of Export Controls," under the authority of the International Emergency Economic Powers Act. Munitions exports are controlled separately under the provisions of the Arms Export Control Act.

The dual-use export licensing process is managed and enforced by the Department of Commerce. The Departments of Defense and Energy review the applications and make recommendations to Commerce. The Central Intelligence Agency and the U.S. Customs Service provide relevant information as well. Customs also enforces licensing requirements for all export shipments except outbound mail, which is handled by the Postal Service.

The 1999 interagency IG report included findings in seven areas. Three of those areas are pertinent to new dual-use export legislation.

The first area related to the adequacy of export control statutes and executive orders. We concluded that, in general, the Arms Export Control Act and the provisions of the Export Administration Act, as clarified by Executive Order 12981, were consistent and unambiguous. However, the Commerce and Defense IG teams stressed that the dual-use licensing process would be best served if the Export Administration Act were reenacted, rather than to continue to operate under a patchwork of other laws and executive orders. In addition, policy and regulations regarding the export licensing requirements for technical information "deemed to be exports" needed clarification, and the exporter appeals process should be formalized.

The second area pertained to procedures used in the export license review processes. The Commerce, Defense, Energy and State IG teams concluded that processes for the referral of dual-use license applications and interagency dispute resolution were adequate. Officials from those Departments were generally satisfied with the 30-day time limit for agency reviews under Executive Order 12981; however, not every agency could meet that limit. Several Defense organizations and the CIA indicated they would benefit from additional time to review dual-use license applications. Another major point was that the Commerce commodity classification process could benefit from additional input on military-related items from the Departments of Defense and State. The commodity classification process matches a prospective export item with an export control classification number. Those determinations indicate whether an item requires an export license and, if so, whether it is licensable by Commerce or State.

The third area pertained to the cumulative effect of multiple exports to individual foreign countries. The U.S. Government lacked meaningful cumulative effect analysis. Some of the

agencies involved in the export licensing process performed limited cumulative effect analyses, but to varying degrees. The Commerce, Defense, Energy and State IG teams concluded that additional cumulative effect analysis would benefit the license application review process.

The IG teams made specific recommendations relevant to their own agencies. Those recommendations and management comments are included in the separate reports issued by each office.

Now I would like to change focus from the interagency report to the report issued by my office on June 18, 1999. Although our report addressed 14 separate issues posed by Chairman Thompson's August 1998 request, for this testimony I will cover only those that relate to the Export Administration Act.

One issue was whether Commerce was properly referring export license applications for review by other agencies.

Defense officials expressed general satisfaction with referrals of dual-use export license applications from Commerce. Conversely, they were concerned that Commerce referred too few commodity classification requests to Defense for review. In FY 1998, exporters submitted 2,723 commodity classification requests containing 6,161 line items to Commerce. From April 1996 through March 1999, a mere 12 of those requests were referred to Defense for review.

Another issue concerned the interagency dispute resolution process for appealing disputed license applications.

The current interagency dispute resolution process provides multiple appeal levels and has given Defense a reasonable opportunity to appeal disputed dual-use license applications. Executive Order 12981 provides for multiple appeal levels. Agencies can escalate disputes regarding applications successively to the Operating Committee, the Advisory Committee on Export Policy, the Export Administration Review Board and the President. Appeals have been infrequent. For example, the Advisory Committee on Export Policy reviewed an average of 48 cases annually from FY 1996 through FY 1998 and there have been no recent appeals to the President.

Other issues related to whether the current licensing processes adequately took into account the cumulative effect of technology transfers.

We found that the licensing process at the Defense Threat Reduction Agency occasionally took into account cumulative effect, but participants in the licensing process did not routinely analyze the cumulative effect of proposed exports or receive assessments to use during license reviews. In addition, Defense organizations did not conduct required annual assessments that could provide information on the cumulative effect of proposed exports. The Defense Threat Reduction Agency has initiated actions to increase the degree to which cumulative effect analysis is incorporated into the licensing process. We recognize that organizing and resourcing a meaningful cumulative effect analysis process pose a significant challenge, but continue to believe that this is clearly an area warranting more emphasis.

Inspector General Reports in March 2000

We recently completed the first of seven annual interagency audits of technology transfer issues mandated by Section 1402 of the National Defense Authorization Act for Fiscal Year 2000. In conjunction with the Inspectors General of Commerce, Energy and State, we focused this year's review on "deemed exports." The results are included in an interagency report dated March 24, 2000. The DoD portion of the results was included in the interagency report and was also issued by us as a separate report on March 24, 2000.

We reviewed controls related to foreign visitors to Government and contractor facilities. For example, foreign nationals visit Federal research facilities for various reasons, as well as under various international agreements and programs. During those visits, foreign nationals may have access to export-controlled software or technology. The release to foreign nationals of technical data that meet the criteria of the Export Administration Regulations or the International Traffic in Arms Regulations is considered an export. According to those regulations, the oral, visual, or written disclosure of technical data to a foreign national may require a "deemed" export license. In general, there is inadequate awareness of licensing requirements for "deemed exports" and widespread noncompliance by both Government and industry. This is an area needing more explicit statutory or regulatory guidelines.

Separate classified reports were also issued in response to the additional Authorization Act requirement for a review of counterintelligence issues related to technology transfer.

In commenting on issues related to a new Export Administration Act, I emphasize that these views are those of the IG, DoD, and do not necessarily reflect the positions of DoD managers or the managers and IGs of other Federal agencies.

As previously mentioned, we believe there is a clear need to reenact the Export Administration Act. During the two decades since that law was enacted, commercial technologies and products have become vastly more applicable to military systems and capabilities, especially in the information technology arena. The Cold War has ended and international trade has expanded. It is vital for our national security that the export control regime for dual-use commodities be firmly grounded in a comprehensive, clear and up to date statute. We further believe that S.1712, the Export Administration Act of 1999, is a good start toward such a statute; however, it needs to be improved in a few areas. We respectfully offer the following observations and suggestions regarding the control of dual-use technology transfers.

Any process prescribed by law or regulation for export controls must strike difficult balances related to efficiency (timeliness) and effectiveness (reasonable and prudent decision making).

Controlling technology transfer is what might be termed a horizontal issue for the Federal Government, in the sense that several agencies and multiple components of those agencies need to participate in any meaningful process. Both within large organizations like the DoD and on an interagency basis, horizontal issues are particularly hard to deal with because Government is organized on a vertical basis. For a cross-cutting process to be effective, there must be objective mechanisms or procedures in place to coordinate agency efforts, resolve conflicting advice and make decisions. It would be prudent to provide explicit statutory underpinning to the interagency dispute resolution process.

The export control license review process must be able to handle a very large number of transactions expeditiously, but without sacrificing the quality of reviews. The Department of Commerce received 10,696 dual-use export license applications in FY 1998 and 12,650 in FY 1999. We do not have a good insight into the

potential for reducing the number of controlled items without undue national security risk, but we are aware that the issue is being discussed within both the Administration and Congress. In addition, the next interagency IG review will focus on both of the existing Control Lists to examine the procedures by which items are added to or deleted from them. Regardless of any changes made to licensing requirements, however, it is virtually certain that the number of export license applications will remain very large. This high volume is a major consideration when both timely processing and due diligence on all application reviews are concerns.

A high volume process will bog down if it is overly complex and if agencies are not willing and able to apply enough resources to execute it effectively. In addition to the sheer volume of export issues to be reviewed, agencies will be continually challenged by the entry of new technologies and products into the market. This will severely challenge the technical expertise of licensing officials, intelligence analysts and other supporting personnel. Agencies should be required to do sound workforce planning, with emphasis on determining required specialties and training, and to develop mechanisms for rapidly augmenting permanent in-house staff when necessary. Efficient information sharing through the use of the best available information technology is also essential. These kinds of management considerations probably are best addressed through regulation, rather than by statute, to provide flexibility.

The most meticulously designed and carefully executed export control process will fail if it is easily circumvented. Therefore we urge particularly close attention during the consideration of new statutory and regulatory guidance on determining the makeup of a Control List and on granting exceptions to export license requirements for controlled items.

The Export Administration Act of 1979 required that a list of DoD-developed militarily critical technologies be integrated into the overall Control List of items requiring an export license. Any disagreement between the Secretaries of Commerce and Defense over the integration of an item on the list of militarily critical technologies into the Control List was to be resolved by the President. We believe those provisions were prudent and any new Export Administration Act should continue to allow appeal, through the interagency dispute resolution process, to the President. No Department should

have unilateral control over adding items to the Control List or deleting them.

Determination of Foreign Availability and Mass-Market Status

One potential reason for deciding not to control the export of a technology or product could be that an equivalent item is already widely sold on the international market. In our opinion, a determination not to put or keep an item on the Control List because of foreign availability and mass-market status should never be made without prior consultation with the national security community and, unless the President directs otherwise, the concurrence of the Secretary of Defense.

Although it is unlikely that Defense would do mass-market and foreign availability analyses, the methodology for doing those studies should be clearly defined and well understood by all agencies that would be interested in the study results. Likewise, all analyses should be well documented and agencies should have formal internal quality assurance procedures to ensure the reliability of their study results. The same principles hold true for cumulative effect analyses.

It would not be the normal role of the IGs or General Accounting Office to perform studies on mass-market and foreign availability or on the cumulative impact of exports to specific countries. However, auditors and evaluators could periodically test the controls for quality assurance for studies. A rigorous peer review program could also be appropriate as part of the quality assurance effort.

We believe it would best serve the national interest to keep any license exception authority fairly limited. Certain high-risk items, for example, those that could contribute to the proliferation of weapons of mass destruction, encryption technology and certain components of jet engines, never should be exported without an export license, regardless of destination.

Commodity Classification Requests

As identified in our 1999 report on the Defense export licensing process, a formal interagency process is needed in determining the commodity classification of an item on the Control List, so that all perspectives can be considered.

Last year, as part of the joint IG review, a statistical sample of 100 commodity classification decisions made by Commerce as well as 3 additional items that were designated as "no license required" were reviewed to determine if a proper commodity classification decision had been made for those items. While Defense was satisfied with Commerce's decision on 90 of the 103 commodity classifications, they felt the remaining 13 were either misclassified or lacked sufficient information. The Commerce and Defense IG teams asked officials to jointly reexamine these 13 decisions. The officials agreed that Commerce had properly classified 4 items and misclassified one item.

There were varying degrees of disagreement on the other 8 decisions. For example, Defense officials questioned a Commerce decision regarding a ruggedized, portable, encrypted radio. Commerce officials stated that the radio had not been built to military standards and therefore was not a munitions item under the jurisdiction of the International Traffic in Arms Regulations. Defense officials noted that literature described the radio as militarized and other radios built by the manufacturer were subject to munitions export licenses. The second request was for an antenna. Commerce officials stated that the antenna was not a munitions item, despite company literature describing it as militarized. Defense officials stated that the literature satisfied International Traffic in Arms Regulations criteria for a "defense article" (munitions) and that the manufacturer had a history of exporting products under the munitions export licensing process.

Anecdotal evidence provided to the auditors suggested that Commerce could make incorrect commodity classification decisions if it does not receive Defense advice on those decisions. In 1995 and 1997, Commerce decided that microchannel plates (used in night vision devices) fell under the Export Administration Regulations even though Commerce, Defense and State had decided in 1991 that this type of item fell under the jurisdiction of the International Traffic in Arms Regulations. In 1995, Commerce determined that a U.S. aerospace company’s accident report on a failed Chinese rocket launch that contained technical data fell under the Export Administration Regulations rather than the International Traffic in Arms Regulations. In 1996, Commerce determined that a protective suit fell under the Export Administration Regulations, while Defense and State held that it was a chemical and biological defensive suit subject to the International Traffic in Arms Regulations.

I do not have a basis for affirming which position was correct in these cases; however, I believe it is clear that these are difficult decisions and the full range of opinion from various elements of the Government ought to be elicited and considered.

In our view, either a law or regulation should require the Department of Commerce to refer all commodity classification requests promptly for Defense review and allow a reasonable time period for Defense to review those referrals. If there is no agreement on the commodity classification, an interagency dispute resolution process should be initiated to determine the final outcome.

Application Review Procedures

Executive Order 12981 prescribed additional procedures for export license applications submitted under the Export Administration Act of 1979. Among other things, those procedures required the Department of Commerce to refer all dual-use license applications to the Department of Defense. Last year's interagency review indicated that those procedures have worked fairly well and we believe a new Export Administration Act should provide for their continuation. It should remain mandatory, under any future procedure, that all applications, unless otherwise delegated by the Secretary of Defense, be referred to the Department of Defense for review.

Summary

The Office of Inspector General, DoD, strongly supports the enactment of a new Export Administration Act. This vital area deserves a comprehensive statutory framework that clearly prescribes the roles and responsibilities of all interested Departments and Agencies. We urge that legislation in this area provide to the Secretary of Defense the authority to ensure that national security concerns are carefully addressed in the dual-use export control process.

The stakes involved in technology transfer decisions are apt to be very high for the applicants, the economy, foreign relations and national security. Therefore the process must provide for clear accountability, as much openness as is possible given that classified matters are often involved, and objectivity. It is vitally important that the process not be perceived as being inherently biased toward the agenda of any particular agency or faction within Government. The best safeguard in that respect is a viable interagency dispute resolution process, applicable to

all facets of the export control program and explicitly underpinned by a new Export Administration Act.

The text of the unclassified reports mentioned in this testimony can be accessed on the Web at www.dodig.osd.mil. The numbers and titles are as follows:

No. 99-186, Review of DoD Export Licensing Processes for Dual-Use Commodities and Munitions, June 18, 1999

No. 99-187, Interagency Review of the Export Licensing Process for Dual-Use Commodities and Munitions, June 18, 1999

No. D-2000-109, Interagency Review of the Export Licensing Process for Foreign National Visitors, March 24, 2000

No. D-2000-110, Export Licensing at DoD Research Facilities, March 24, 2000

Thank you for considering our views.