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STATEMENT OF

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BEFORE THE

SUBCOMMITTEE ON INTERNATIONAL FINANCE AND MONETARY POLICY

SENATE COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS

ON THE [ADMINISTRATION OF

EXPORT CONTROLS UNDER ~~THE~~ EXPORT ADMINISTRATION ACT]

Mr. Chairman and Members of the Subcommittee:

We are pleased to be here today to share with you our views on the export control system for commercially available commodities as administered by the Department of Commerce and a group of consulting agencies. As you know, under the Export Administration Act, the United States controls the export of "dual use" commercial products and processes for national security, foreign policy and short supply purposes. Our current review addresses congressional concerns about how well the system is carrying out the Act's national security goal of controlling exports of militarily significant technology and products to Russia and other Eastern bloc nations. This particular aspect of the control system requires that the Department of Defense must be consulted by Commerce and that Defense may recommend that the President deny any application on national security grounds.)

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The administration of export control is an onerous paperwork system that draws criticism from all sides. U.S. industry complains about cumbersome, inconsistent and unnecessarily rigid procedures and that uncertainties in the system impact on their reliability. Thus, they maintain, sales are lost or potential markets cannot be expanded. Other critics believe that the system is too loose and that inadequate safeguards are permitting the Communist countries to enhance their military capabilities through U.S. technology.

To evaluate the system, we selected a random sample of 94 license applications approved for shipping technology to the Eastern bloc. We also reviewed actions taken to amend the control lists and to enforce compliance with control legislation.

We found that

- criteria for inclusion of technology subject to control is too broad--far fewer items are actually being controlled;
- a large part of the system is simply a paper process which overly burdens U.S. exporters and reduces the time available to review important applications;
- the review of critical cases should be improved; and
- there are serious constraints to deterring unauthorized exports.

We believe that with more narrowly focused control criteria and procedures, the current system can better protect national security while lessening the burden on U.S. exporters. Before elaborating on these points, we would like to discuss some of the

important influences that have a bearing on how the export control system operates.

INFLUENCES ON THE
EXPORT CONTROL SYSTEM

The export control system consists of three principal activities: (1) identifying technologies and products that need to be controlled, (2) deciding on individual export license applications, and (3) providing an effective deterrent to unauthorized exports.

Recognizing that effective export control for Communist country destinations requires international cooperation, the United States carries out these activities in conjunction with its NATO partners and with Japan. This informal organization, referred to as the Coordinating Committee, or simply COCOM, establishes a common list of items which participating governments will control for reasons of mutual security.

Under the COCOM mechanism, members must all agree on items added or deleted from control. Since compromise is a critical element of the process, members obviously do not get all that they want--be it for more control or less. In the last COCOM list review, for example, we were told that the United States has achieved most of what it wanted. This apparent success, however, must be tempered by the fact that Defense technicians wanted more items controlled than the U.S. position called for and no agreement has yet been reached on some of the more critical items, most notably, computers, lasers, and numerically controlled machines.

Currently, COCOM member governments control 125 categories of industrial items. In addition, the United States unilaterally controls 33 items for national security reasons, including

technologies and products unique to the United States and items for which more control than agreed to in COCOM has been deemed appropriate.

Within the COCOM community, or for that matter within the U.S. licensing system, there are different levels of control. Militarily significant items, or items which we will refer to as high technology items, require unanimous approval from all COCOM members prior to export and are referred to as exception requests. On the other hand, lesser technology requires only that a member notify the other members that such items have been exported. In effect, such items are freely exportable. The United States, for example, approves almost all such items for export with little or no review.

Not only is the distinction between high and low technology defined in the COCOM list, but the U.S. Government also uses such criteria to determine what cases receive critical review by Defense. Commerce is delegated the authority by Defense to decide on low technology applications without referral to Defense. We might note, in this connection, that such distinctions are not part of the Commodity Control List provided to U.S. industry.

Changing national priorities

Another important influence on the control system is that it is a reflection of changing national priorities -- both legislative and foreign policy. Since 1969, export control legislation, has been shifting toward liberalizing controls on trade with Communist nations. This can be seen by looking at the U.S. unilaterally controlled list of items which has declined from 494

in 1971 to just 33 in 1981. This does not mean, however, that there have not been continuing concerns about the strategic implications of U.S. East-West trade.

In the foreign policy area, there have been alternating political highs and lows in U.S. relationships with Communist countries. This includes shifts from a virtual trade embargo just after World War II to liberalized trade during the detente period and then recently back to a partial embargo on Soviet trade as a result of the Afghanistan invasion. These policy shifts affected the export control system by making decision-making more restricted during confrontation periods and more permissive during cooperative periods. Thus, the licensing process becomes a vehicle for foreign policy implementation. This is seen in the subsequent controversy that has surrounded the approval of certain "celebrated" cases of technology transfer, during the period of detente, such as ball bearing machines, high powered computers and heavy truck manufacturing facilities.

Another illustration is the recent liberalizing of trade with the Peoples Republic of China. The resulting rapid increase in exports of products with dual use potential to that nation could be subject to strong criticism and concern sometime in the future if relations with the PRC were to deteriorate. We are not making a judgment on these shifts in foreign policy, but are merely pointing out their importance in operating the export control licensing system.

CONTROL CRITERIA SHOULD
BE MORE NARROWLY FOCUSED

To understand what industrial exports are eventually controlled by the U.S. Government for national security reasons, one must go beyond the Commodity Control List (CCL) to identify which applications were reviewed by the Defense Department. In doing this, we found that there is genuine concern with only a small percent of the total number of export applications received. In 1980, for example, the U.S. licensing system handled 80,000 industry applications for export of CCL items to various destinations. Of this total, only 3,000 were reviewed by the Defense Department. Even for Warsaw Pact countries, our random sample showed that Defense reviewed only 30 percent of the applications approved for those countries.

Why does Defense review so few applications? The answer stems from the fact that Defense asks to examine only those cases involving high technology. Defense has concluded that lower technology exports do not constitute a significant military risk and that Commerce should assess the risk without Defense review. Accordingly, Defense has delegated authority to Commerce to decide all such cases. These delegations of authority cover most items on the CCL and contain specific performance characteristics above which Commerce must send the application to Defense for review. Delegations of authority also apply to destinations. Consequently, what is considered high technology for one country may not be for another. The most restrictive standards are for the Communist bloc countries.

Because the vast majority of applications involve low technology and are routinely processed with little if any review, the licensing system has largely become a meaningless paper exercise. Such a situation clearly detracts from the importance of control and raises serious questions as to whether low technology items should require export licenses.

On this point, the Congress has supported eliminating controls for items that no longer represent a military risk. For example, section 5(g) of the Export Administration Act states that:

"INDEXING-In order to ensure that requirements for validated licenses and qualified general licenses are periodically removed as goods or technology subject to such requirements become obsolete with respect to the national security of the United States, regulations issued by the Secretary [of Commerce] may, where appropriate, provide for annual increases in the performance levels of goods or technology subject to any such licensing requirement. Any such goods or technology which no longer meet the performance levels established by the latest such increase shall be removed from the list * * *."

Industry has also argued for stronger decontrol of exports, particularly to the non-Communist world. The executive branch, however, has done little with regard to formal decontrol. During the most recent COCOM review, the United States introduced only two proposals for indexing and both were later withdrawn. Further, since passage of the 1979 Act, the United States has eliminated no unilateral controls.

One would think that, over time, low technology items would have been eliminated from licensing requirements. This has not happened, apparently because of a desire not to weaken the mechanism now available for changing controls in response to foreign policy shifts, the need for export information, and an unwillingness to reduce the margin of safety in the system.

As to weakening our response to foreign policy shifts, we believe that eliminating low technology items from control does not preclude the Government from subsequently embargoing commodities. With regard to information needs, the Government would continue to receive sufficient information on decontrolled exports through shippers' export declarations, which are required on all U.S. exports, licensed or not. Finally, the definition of high technology includes a safety margin. Defense approves many exceptions in the high technology classification, suggesting that lower technology can be decontrolled without losing the necessary safety margin.

In summary, since the Government does not now critically review low technology exports, such items, as defined for Warsaw Pact countries, could be removed from licensing requirements without jeopardizing U.S. national security. Such action would remove an unnecessary and costly burden from both industry and Government and free more resources to review high technology applications.

CRITICAL CASE REVIEW
SHOULD BE IMPROVED

To analyze how national security cases were being reviewed, we randomly selected 94 approved cases processed just before and after the Russian invasion of Afghanistan. The Department of Defense has the key role in reviewing cases involving militarily significant technology; and it is generally making a good review of these cases; but that review could be improved. We also found problems in the way in which the Commerce Department is carrying out its important responsibility to identify the significant

cases for Defense review. We identified ways that the national security review process can be improved.

The system, however, does deny more national security sensitive applications than is commonly perceived. Although less than one percent of the total applications processed by Commerce are denied, this figure increases significantly when one examines the situation regarding Warsaw Pact destinations. For example, in the last quarter of 1979, and prior to the invasion of Afghanistan, 7.7 percent of requests for export to the Warsaw Pact countries were denied. Furthermore, if only the high technology exports to the Pact are considered, approximately one out of every four cases was denied. In addition, our sample cases indicated that about 7 percent of the approved Warsaw Pact cases were modified to reduce the technical capabilities of the items before they could be exported.

Defense's key role in analyzing cases

Defense's evaluation of high technology cases for potential military significance is carried out by the Defense Research and Engineering staff with the assistance of the military technical commands, certain technical experts, and Defense intelligence. We looked at 14 of the 28 cases in our sample that Commerce sent to Defense for review. We found that 12 of the 14 cases received technical command input; 8 cases were recommended for approval but, in four of these cases, at least one of the technical commands recommended denial.

--In three cases the denial was overruled by approving the items with limits on the technical specifications or reducing the equipment's performance characteristics.

--The remaining case was approved without conditions following detailed discussion with the command.

Defense officials acknowledged that the technical commands frequently have differing opinions on recommendations. Defense Research and Engineering sometimes overrules technical command positions because they are not adequately supported. On the other hand, there have been cases where the technical commands recommended approval, but because of other considerations, Defense recommended denial.

In 1979, we reported that the technical commands were not specifically funded for export licensing reviews and this still hampers Defense Research and Engineering officials. As a result, technical command reviews receive a low priority and according to Defense officials, the cases are not always assigned to the best qualified people. Defense officials indicated that the technical commands' reviews are critical and they could be made much better if they were part of their specifically assigned duties with appropriate funding instead of having the costs covered by the budget for overhead.

Defense intelligence makes checks on the designated end users plus some technical analyses for all Soviet Union cases and some other Communist country cases. Greater emphasis was placed on these reviews starting in 1979. Before then, only about 25 cases were reviewed a year but this has increased now to more than 100 per month. According to Defense officials about 2 to 3 percent of the cases have been found to involve unacceptable end users and another 5 to 6 percent have been found to involve questionable end users. Defense intelligence is scheduled to

receive an increase in funding for this activity in its fiscal year 1982 budget. Defense noted that this inhouse intelligence effort is necessary because it cannot rely on Commerce's identification of end user activities.

Some problems with Commerce's initial reviews

The trigger mechanism for getting the proper cases to Defense is Commerce's identification of the technical specifications of each proposed export. Commerce refers to the delegations of authority from Defense in making the decisions on whether Defense should review a case. We found that there is a problem with the way Commerce is carrying out this responsibility. For example, Commerce failed to send Defense 3 of 31 cases, or about 10 percent of such cases in our sample, that should have been sent for review according to the delegation of authority criteria. In two of the cases, Commerce officials said precedent was involved and that such precedents were interpreted under the delegations to allow them to approve the cases without referral to Defense. However, the third case did not involve such interpretation and, therefore, was in clear violation of the delegation, and Defense had no opportunity to deny the sale as allowed under the law.

Another problem is that Commerce is not getting the cases to Defense in a timely manner. Under the Export Administration Act, within 10 days from receipt of an application Commerce must make an initial decision whether or not the application requires Defense and other agency review. This action is not being completed within the required timeframe and often takes about

30 days. Therefore, the reviewing agency has that much less time to analyze the case. Defense complains about this and adds that over the last 1-1/2 years, Commerce did not provide enough information to analyze many of the cases.

We also identified various management weaknesses within Commerce's daily processing of export license applications, including (1) the need to streamline the flow of applications within the system and eliminate duplicative review efforts, (2) institute an adequate system for monitoring safeguard provisions which are added to certain licenses before they are approved, (3) require greater accountability through better recordkeeping, and (4) update the Office of Export Administration procedures manual. Commerce is currently addressing some of these problems and expects to improve its operation.

INEFFECTIVE DETERRENT TO
UNAUTHORIZED EXPORTS

The third important aspect of the control system is enforcement of the export control law. As you know, the export control process for the most part is an honor system which relies on the basic integrity of the export community and its willingness to abide by the law.

Major difficulties accompany the enforcement effort. There are some 300 air, sea, and highway exit points from the United States and there are also frustrating difficulties involved in dealing with enforcement abroad. Therefore, any effort that would be comprehensive enough to insure compliance with controls would probably be cost prohibitive. However, better use could be made of available resources.

Detecting unauthorized shipments

During 1980, Commerce's compliance activity opened 354 investigations of alleged violations of the Export Administration Act. It also imposed administrative penalties in 12 instances. Further, the Justice Department imposed criminal penalties against four individuals. This compares to 224 investigations, 11 administrative penalties and two criminal penalties in 1978.

At the same time, the backlog of uncompleted investigations at Commerce has grown from 189 in fiscal year 1976 to 426 in fiscal year 1980. Many of these cases also involve alleged unlicensed technology exports, which may result in criminal or administrative penalties.

Rapid changes in technology have increased the desirability of U.S. products, and miniaturization of computer programs and other products have made clandestine shipment easier. Also, it is reported that policy restrictions on exports to the Soviet Union following the invasion of Afghanistan have made violations even more profitable.

The FBI reports that Russia has stepped up its attempts to obtain Western technology, especially computers, microelectronics, fiber optics, and lasers. The FBI has increased its foreign counterintelligence effort--an area that includes export control. However, the FBI has not been asked by Commerce to investigate any specific cases, nor does it feel it has statutory authority for enforcing the Export Administration Act. Its work involves export control only as a part of its counterintelligence work.

Another major problem is that such items can also be easily diverted after leaving U.S. shores. Of course, the magnitude of such diversions can only be estimated, but Government agencies have reported on the problem. The State Department noted that in 1980 about 45 diversion cases were discussed within an inter-agency committee. Also about 36 potential violations involving alleged illegal exports of computers, semi conductor technology, and other sophisticated electronic equipment were discussed with foreign governments during 1980.

Such problems can and have occurred not only in other countries but within the COCOM countries themselves. Obtaining an adequate degree of cooperation among COCOM members in investigating and prosecuting diversion cases is difficult. Each violation is handled on a case-by-case basis and no formal mechanism exists to coordinate and assist each countries' efforts.

How effective is the Government's enforcement effort?

A recent National Security Council export control study identified two major areas of concern--insufficient resources devoted to enforcement, and lack of adequate coordination among Government agencies concerned with export control enforcement.

As we acknowledged above, insuring full compliance is not really feasible considering the enormity of the potential problem; but better use could be made of available resources. As an example, Commerce has made very little effort toward adopting recommendations we made in a 1979 report. Random cargo inspections are not yet being made at a representative sample of ports of exit nor are they scheduled around the clock or on weekends.

Furthermore, Commerce still has not yet tightened its management of the program to monitor the end use of critical items, although efforts continue to include onsite visitation clauses in approved license applications.

We are prepared to repeat our prior recommendations regarding compliance efforts and suggest that greater cooperation be pursued not only among our own agencies but with the COCOM countries as well. In this regard, we believe that our proposal for adjusting the criteria for control will also assist in alleviating the inspection workload and encourage other countries to better control that which is really important.

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Mr. Chairman, we believe that potential adjustments to lighten the export control workload exist, and that these might well be considered before more resources are applied to the system.

This concludes our prepared statement and we will be happy to answer any questions that you may have on the points we have covered today.