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BY THE U.S. GENERAL ACCOUNTING OFFICE

Report To Senator Charles H. Percy

Administration Knowledge Of Economic Costs Of Foreign Policy Export Controls

The Export Administration Act of 1979 requires consultation, as appropriate, with businesses affected by proposed controls and consideration of the controls' economic impact. GAO found that although there was minimal formal business consultation, the business community and the Commerce and State Departments did provide decision-makers with the essential economic arguments against the use of export controls.

Administration economic analyses usually did not provide estimates of the controls' indirect effects, but important limits exist to Commerce's ability to better quantify such economic costs.

GAO's review does not support the conclusion that the administration might have acted differently had it been aware of the total economic costs, and it shifts the debate back to the usefulness of such foreign policy controls.

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UNITED STATES GENERAL ACCOUNTING OFFICE
WASHINGTON, D.C. 20548

NATIONAL SECURITY AND
INTERNATIONAL AFFAIRS DIVISION

B-207769

The Honorable Charles H. Percy
United States Senate

Dear Senator Percy:

This report was prepared in response to your request that we examine the extent of economic analysis and business consultation carried out by the administration when imposing foreign policy export controls.

Based on four case studies of control imposition, the report describes the kinds of ongoing, informal discussions the administration held with the business community despite the minimal nature of any formal business consultations. The report also highlights the constraints on the Government's ability to prepare thorough analyses of the ripple effects of control actions and the difficulties of removing foreign policy controls once they are imposed.

As arranged with your office, unless you publicly announce its contents earlier, we plan no further distribution of this report until 30 days from the date of issue. At that time, we will send copies to interested parties and make copies available to others upon request.

Sincerely yours,

Frank C. Conahan

Frank C. Conahan
Director

GENERAL ACCOUNTING OFFICE
REPORT TO SENATOR
CHARLES H. PERCY

ADMINISTRATION KNOWLEDGE OF ECONOMIC COSTS OF FOREIGN POLICY EXPORT CONTROLS

D I G E S T

To ensure that the domestic economic impact of foreign policy export controls is considered, Congress required in the Export Administration Act of 1979 that the administration (1) consult, as appropriate, with businesses affected by the proposed controls and (2) consider the economic impact of such controls during the process of imposing them. At the request of Senator Charles H. Percy, GAO examined the extent to which the administration complied with these provisions.

GAO made this review by examining foreign policy controls imposed on (1) oil and gas-related exports to the Soviet Union effective December 30, 1981, and June 22, 1982, and (2) exports to Libya effective October 28, 1981, and March 12, 1982, and the revision of existing controls on South Africa during 1981-82. (See pp. 2-5.)

GAO did not examine several other issues regarding foreign policy controls, including administration compliance with the Export Administration Act's other criteria governing the imposition of controls, such as the effectiveness of unilateral controls in achieving their stated objectives, extent of consultation with U.S. allies, and consideration given to alternative foreign policy options.

FOREIGN POLICY PURPOSES OVERRODE KNOWLEDGE OF ADVERSE ECONOMIC EFFECTS

The export control decisions reviewed by GAO were contemplated by the administration several months before their actual imposition. During this time, the business community and the Commerce Department gave decisionmakers some estimates of direct export sales that would be lost and the key economic arguments against controls. The administration knew of the adverse economic effects when it made its decisions. Administration representatives stated that the expected foreign policy benefits of controls overrode economic concerns.

BUSINESSES WERE NOT CONSULTED BUT ADMINISTRATION KNEW KEY OBJECTIONS

Little or no formal business consultation took place before foreign policy controls were imposed, but ongoing business-Government discussions in the months before controls were imposed did inform the administration of (1) business' basic objections to controls and (2) the controls' effects on individual companies in at least a few important instances. (See ch. 2.)

Through Government-sponsored policy advisory groups, most notably the Advisory Committee on East-West Trade, and individual contacts with administration officials, businesses transmitted their key concerns about (1) foreign suppliers replacing them in world markets by taking advantage of unilateral U.S. control actions, (2) damage to their reputations as reliable suppliers, (3) adverse consequences of violating signed contracts, and (4) economic and political problems resulting from the extraterritorial extension of controls. (See pp. 10-13.)

Decisionmakers were reluctant to consult earlier and more actively with business because of the possibility that leaks to the news media would reduce the controls' foreign policy effectiveness by enabling target countries to take countervailing measures. (See p. 8.)

The public comment periods after the imposition of controls have proved to be of only limited usefulness as opportunities for business to provide useful information to the decisionmakers, because (1) the administration has needed to relate relaxation of controls to some progress in achieving their initial foreign policy purposes and (2) businesses have sometimes been reluctant to publicly reveal the extent of their trade interests in the unpopular target countries. (See pp. 13-14.)

LIMITED U.S. GOVERNMENT ANALYSES OF ECONOMIC IMPACT WERE TRANSMITTED TO DECISIONMAKERS

During the several months that controls for the Soviet Union were being considered, Commerce analysts did give decisionmakers estimates of direct export sales to be lost. These estimates were based on prior year exports and known upcoming major sales. They did not estimate the indirect effects of controls, such as secondary supplier effects and lost U.S. jobs and Government revenues.

Important limits in Commerce's ability to more thoroughly quantify economic costs include lack of data on exports not subject to any controls, prospective export sales, effects on subcontractors, and foreign availability of substitute goods or technology. Also, the impact of controls on U.S. companies' reputations as reliable suppliers is extremely difficult to calculate but is perhaps the most important adverse effect on long-term U.S. export interests. (See ch. 3.)

GAO believes that revising the Act to require more economic analysis will not alter the decisions made and that the choice for Congress is between relying on Presidential judgment for appropriate use of foreign policy controls and limiting or removing from the Act authority to impose such controls. For example, prohibiting the use of controls when foreign availability exists would in effect greatly reduce the President's ability to use export controls as a foreign policy tool. (See ch. 4.)

AGENCY COMMENTS

The State Department agreed that more economic analysis will not alter decisions made and emphasized the inherent constraints of the Government's information base in assessing all the economic effects of controls. Both State and Commerce stressed the need to highlight the report's observations regarding the administration's desire for secrecy in decisionmaking and their record of informal, ongoing contacts with affected businesses prior to control action. They both also noted that business comments received during public comment periods can be useful in revising controls. (See pp. 14-15 and 26-27.)

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ABBREVIATIONS

ACEWT	Advisory Committee on East-West Trade
EAA	Export Administration Act
GAO	General Accounting Office
ISACs	Industry Sector Advisory Committees
ITA	International Trade Administration
NSC	National Security Council
OEA	Office of Export Administration
SITC	Standard International Trade Classification

CHAPTER 1

INTRODUCTION

To limit Presidential use of foreign policy export controls, Congress enacted in the Export Administration Act of 1979 several criteria governing the imposition of controls. At the request of Senator Charles H. Percy, this report examines the extent to which the administration complied with the criteria requiring it to (1) consult, as appropriate, with businesses affected by the proposed controls and (2) consider the economic impact of such controls during the process of imposing them. It also provides some information on the issue of compensation for adverse economic effects.

EXPORT ADMINISTRATION ACT CRITERIA

The Export Administration Act (EAA) of 1979 authorizes the President to restrict the export of goods and technology where necessary to further significantly the foreign policy of the United States or to fulfill its declared international obligations. At the same time, the Act declares U.S. policy to be one of encouraging international trade.

To limit the use of foreign policy export controls, the Congress in 1979 added to the EAA (sec. 6b) specific criteria requiring the President, when imposing, expanding, or extending foreign policy controls, to consider the:

1. Probability that such controls will achieve the intended foreign policy purpose, in light of other factors, including the availability from other countries of goods or technology proposed for such controls.

2. Compatibility of the proposed controls with U.S. foreign policy objectives, including the effort to counter international terrorism, and overall U.S. policy toward the proposed target country.

3. Reaction of other countries to the imposition or expansion of such controls.

4. Likely effects of the proposed controls on U.S. export performance, competitive position in the international economy, and international reputation as a supplier of goods and technology and on individual U.S. companies and their employees and communities, including effects on existing contracts.

5. U.S. ability to enforce the proposed controls effectively.

6. Foreign policy consequences of not imposing controls.

The Act also requires that the Secretary of Commerce, before imposing controls, consult with affected U.S. industries, as the Secretary considers appropriate, concerning criteria 1 and 4.

As the language indicates, the President is not bound to do more than consider these criteria, and the Secretary may not consider it appropriate to consult with affected industries. In addition, there is no legal requirement for economic impact statements. The intent of the Congress that business be consulted and economic analysis be performed during the process of imposing controls, however, is strongly supported by the legislative history of section 6b.

PROCESS FOR IMPOSING CONTROLS

The decision to impose major new foreign policy export controls is usually made by the President in consultation with the National Security Council (NSC) and is implemented by the Secretary of Commerce in consultation with the Secretary of State and other agencies the Secretary of Commerce considers appropriate. Authority to impose controls has been delegated to the Director of the Office of Export Administration (OEA) in Commerce, but in practice no official below the Undersecretary for International Trade has authorized controls.

The Commerce Department is responsible for consulting with industry and for performing the economic analysis required by the Act. The State Department is responsible primarily for assessing the foreign policy objectives and impact of proposed controls.

A Senior Interdepartmental Group on International Economic Policy was set up in the summer of 1982 and would consider any new controls proposed by the White House; however, no new controls have been imposed since the inception of this cabinet-level review system.

OBJECTIVES, SCOPE, AND METHODOLOGY

The objective of our review, as guided by the congressional request (see app. I), has been to examine how the EAA's provisions requiring business consultation and economic analysis have actually been implemented over the past 2 years. As case studies of the implementation of these provisions, we chose the imposition of such controls on the Soviet Union on December 30, 1981, and June 22, 1982, and those imposed on Libya on October 28, 1981, and March 12, 1982. To identify the factors leading to major reductions in existing controls, we reviewed the revisions of foreign policy export controls for South Africa over the past 2 years.

We did not examine several other issues surrounding the use of foreign policy export controls. These include effectiveness of unilateral controls in accomplishing their stated objectives, extent to which the administration sought the cooperation of U.S. allies or considered alternative foreign policy options, and ability of business to circumvent controls by exporting goods before the controls were imposed.

We examined Commerce and State Department and NSC documents, including classified documents, and talked with responsible agency officials. We also spoke with business and trade association representatives regarding their communications with the Government about these controls. Our review was made in accordance with generally accepted Government auditing standards.

BACKGROUND ON OUR CASE STUDIES

Our case studies cover several of the major foreign policy export control actions taken within the past 2 years.

Controls on exports to the Soviet Union

Over the past several years, foreign policy controls on the Soviet Union have affected U.S. exports of agricultural commodities and phosphates,[1] 1980 Summer Olympics-related goods,[2] engine assembly lines for the Kama River Truck complex, and oil and gas equipment and technical data.

As recent case studies for our review, we chose the controls imposed on December 30, 1981, and June 22, 1982, on exports to the Soviet Union of oil and gas equipment and technical data.[3] The December 1981 controls cut off the export of all oil and gas-related equipment and technical data to the Soviet Union in two steps. First, the previous requirement for validated export licenses for exploration and production-related items was expanded to include those related to transmission and refinement. Second, the processing of all export licenses for the Soviet Union was suspended. The June 1982 controls (known as the extraterritorial controls) expanded coverage of the oil and gas controls to include (1) exports of foreign-origin goods and technical data by U.S.-owned or controlled companies abroad and (2) foreign-produced products of U.S. technical data not previously subject to controls.

The controls were imposed "in response to the Soviet Union's heavy and direct responsibility for the repression in Poland." Their officially stated purpose was to serve as a "flexible foreign policy tool to be used, when necessary and appropriate, to sensitize the Soviets regarding actions that are damaging to United States foreign policy interests."

Controls on exports to Libya

The United States has had foreign policy controls on exports to Libya of off-highway wheel tractors and crime control equipment since 1978 and on large aircraft and helicopters and certain other commodities and technical data since 1980.

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[1]These controls were terminated Apr. 4, 1981.
[2]These controls lapsed on Jan. 20, 1983.
[3]These controls were terminated Nov. 13, 1982.

On October 28, 1981, additional controls were imposed on small aircraft, helicopters, and aircraft parts and avionics to "limit Libyan capacity to support military ventures in neighboring countries."

Comprehensive controls were imposed on March 12, 1982, requiring validated export licenses for all commodities and technical data except food, agricultural and medical goods, and certain other items.

The stated purpose of these comprehensive controls was to "restrict a U.S. contribution to, and thereby to limit, Libyan capacity to engage in activities detrimental to the foreign policy of the United States." These controls were specifically designed to deny to Libya U.S.-origin national security items and oil and gas equipment and technical data unavailable from foreign sources and to monitor other exports.

The regulations had limited extraterritorial effects; and on a case-by-case basis, they allowed

--exports under existing contracts where failure to obtain a license would not excuse performance under the contract;

--reexports of goods or technology not controlled for national security purposes which were already outside the the United States on the effective date or exports of foreign products incorporating such items as components; and

--the use of U.S.-origin components in foreign-origin equipment, provided they represent less than 20 percent of the value of the equipment.

The regulations also allowed for favorable consideration of applications for reexport of goods or technical data controlled for national security purposes and exported prior to March 12, 1982, and other pre-existing contractual commitments. In addition, a "savings clause" allowed shipments under existing licenses that were being moved for export at the time controls were imposed.

Reduction of controls on South Africa

In February 1978, the United States imposed a total ban on all exports of goods and technical data destined directly or indirectly for the South African police or military. This was a unilateral U.S. action, greatly expanding the embargo on arms sales that the United States had enforced since 1962 and the United Nations had mandated in 1977. The purpose of the controls was to "strengthen the United Nations arms embargo, to distance the United States from the practice of apartheid, and to promote racial justice in southern Africa."

As part of an overall review of foreign policy controls in 1981, the Reagan administration sought to identify possible revisions in the South African controls to allow exports to the South African police or military when such exports were deemed to make no contribution to the enforcement of apartheid and when they were freely available from foreign sources. Limited exceptions to the embargo had been made in 1979 and 1981 to permit exports of medical materials and airport security devices. Government officials asserted that this review resulted in removing controls that were "detrimental to U.S. business while having little, if any, impact on South African adherence to apartheid."

The March 1982 revision of controls had the effect of:

--Permitting five categories of goods and data to be exported to the police or military under a general license.

--Permitting other goods and data to be exported under validated licenses subject to determinations that the exports would not "contribute significantly to military or police functions."

--Establishing two de minimis provisions: one allowing the export of U.S. components that would constitute up to 20 percent by value of goods assembled overseas and sold to the South African police or military and the other permitting reexport of or resale to the military or police of insubstantial portions of items originally sold to other purchasers if the items would not contribute significantly to police or military functions.

--Retaining the ban on exports to the police and military for goods and technical data controlled for national security purposes.

The September 1982 revisions allowed air ambulances, equipment service manuals, miscellaneous electronic products, and certain other items to be exported to the police or military.

In January 1983, controls were further lifted on exports to the police or military of nonstrategic metal-working machinery, chemical and petroleum equipment, transportation equipment (except automotive vehicles and water craft), metals and minerals, and rubber products (except tires). At the same time, items controlled for crime control or nuclear non-proliferation reasons were banned from sale to the police or military.

CHAPTER 2

OPPORTUNITIES FOR BUSINESS CONSULTATION

The business consultation provision of the EAA of 1979 requires the Secretary of Commerce, before imposing foreign policy export controls, to consult with such affected U.S. industries as he considers appropriate. In three of our four case studies, the Secretary did not engage in any formal business consultation process, and in the fourth case, businesses describe the consultation process as inadequate. Businesses maintain that, had they been seriously consulted in advance, they could have provided important information that the Government was lacking.

In the months preceding the actual imposition of the controls, however, ongoing business-Government contacts did serve to inform the administration of business' essential concerns about the economic effects of foreign policy controls and of the likelihood that such controls would accomplish their intended foreign policy objectives. The administration, in fact, made its decisions in spite of business' arguments, citing the predominance of the controls' foreign policy purposes.

The administration did not engage in more formal and earlier business consultation because it thought that urgent and secret control actions were necessary and that consultation might result in leaks to the news media which might reduce the controls' foreign policy effectiveness. Also, it felt it had obtained sufficient information informally to understand the economic effects reasonably well.

Once controls are announced publicly and during the end-of-year extension process, the Commerce Department does formally solicit public comments from the business community. These public comment periods have proved to be of limited usefulness as consultation opportunities, however, because of (1) the political difficulties of removing controls without some progress toward achieving their foreign policy goals and the (2) reluctance of many businesses to reveal possible dollar losses or publicize their individual business interests in the unpopular target countries.

FORMAL BUSINESS CONSULTATIONS

The administration had been considering foreign policy controls on exports of energy-related equipment and technology to the Soviet Union and on light aircraft and other exports to Libya for several months before finally imposing them. But it was only at the very last moment that the administration attempted to consult formally with affected businesses, and the few businesses that were contacted said they were simply informed of decisions already made.

The Commerce Department admits that its consultations with industry were minimal for the Soviet controls of December 1981 and June 1982 and for the Libyan light aircraft controls of October 1981.

For the export controls on Libya of March 12, 1982, Commerce held what one responsible Commerce official called a "model" consultation. This formal meeting with known and available U.S. exporters to Libya was held Thursday, March 4, 1982. Commerce invited the businesses on March 3 without revealing the purpose of the meeting. Commerce and State officials briefed the business representatives on Thursday afternoon and asked for their comments on the proposed controls by Friday, March 5. Participants were asked not to discuss the proposed controls outside of the meeting. The questions Commerce specifically asked business to answer closely followed the provisions of the EAA of 1979, requiring consideration of the

--foreign availability of the goods or technology;

--likely effects on the company's and the industry's export performance;

--effects on competitiveness overseas;

--effects on the company's reputation as a reliable supplier; and

--impact on existing contracts.

Business representatives were highly critical of this approach to business consultation, particularly because:

--With such minimal advance notice of the meeting and without being informed of its purpose, they were not prepared to give complete information, either at this meeting or 1 day later.

--Not all exporters to Libya were informed or could attend the meeting.

--The administration's detailed description of the proposed controls convinced most of them that the decisions had already been made, the foreign policy goals of the controls were paramount, and this meeting was just a <u>pro forma</u> exercise.

--Commerce and State officials could not give definite answers to several important questions raised regarding the actual application of the regulations.

--The meeting produced alarm and uncertainty among the business representatives about how widespread the controls' effects would be.

Despite these criticisms, many businesses did manage to get some information back to Commerce by Friday afternoon. Many of them were able to describe in detail the controls' estimated effects on current and potential sales (including spare parts), possible repercussions on trade with third countries, likely damage to their reputations as reliable suppliers, widespread foreign availability of most of the controlled items, and estimated effects on company earnings.

Commerce sent a summary of this information to the NSC before the controls actually were announced on March 12, 1982. In our opinion, this summary accurately described business criticisms, both of the consultation process and of the controls' basic adverse trade effects.

The arguments made by business during this consultation process, however, did not dissuade the administration from imposing controls.

ADMINISTRATION RELUCTANCE TO INFORM BUSINESS OF POTENTIAL CONTROLS

As the major reasons why so little formal business consultation was carried out prior to export control action, administration officials cited the:

--Time urgency essential for controls to have maximum foreign policy impact.

--Need to avoid leaks to the news media which might (1) dilute the foreign policy impact of the controls decision, (2) allow measures to be taken by the target countries and by U.S. exporters to circumvent the controls, and (3) result in the U.S. foreign policy decisionmaking process being conducted in public.

--Knowledge of basic economic costs they had obtained from prior informal and ongoing contacts with business.

--Necessary predominance of the controls' foreign policy objectives over consideration of domestic economic costs

INFORMATION THAT BUSINESS WOULD HAVE PROVIDED IN CONSULTATIONS

Business representatives maintain that they could have provided important information to administration policymakers, had they been consulted earlier in the process of imposing controls.

For the controls of December 1981 and June 1982 on exports to the Soviet Union, the representatives say they would have advised the administration that such controls would:

--Be ineffective and would result in a permanent loss of parts of the Soviet market for U.S. exporters because most of the controlled items were available from, and would be supplied by, foreign sources.

--Not be tolerated by European governments which would dispute the extraterritorial controls in international courts and would refuse to abide by them.

--Have wide-ranging effects on secondary suppliers.

--Have extraordinarily complicated repercussions on U.S. trade with third countries.

--Seriously damage their reputations as reliable suppliers.

--Have disproportionate economic effects on the State of Illinois in lost sales, jobs, and tax revenues.

For the controls on exports to Libya, business representatives say they would have provided details concerning the:

--Importance of continuity and speedy availability in supplying spare parts and maintenance to their Libyan operations.

--Adverse effects on the safety of their operations that would result from interruption in their spare parts supplies.

--Inequitable effects of the regulations; i.e., repair services based on maintenance contracts could be allowed but those provided on a per-incident basis would not.

--Ineffectiveness of unilateral controls on U.S. exports widely available from foreign sources, the resulting loss of U.S. markets in Libya and possibly other Middle Eastern countries, and damage to U.S. exporters' reputation as reliable suppliers.

--Concern that Commerce Department staff could not expeditiously handle the additional license application workload.

Because Government representatives were unable to answer many of business' questions at the March 4, 1982, meeting, some business representatives felt the Government had not been aware of these concerns when planning the controls and that earlier consultation would have brought these concerns to the administration's attention and might have modified the controls to alleviate their concerns.

Business representatives stated that they are willing to provide full information on pending and potential sales on a confidential basis, so that the economic effects of controls would be fully understood and considered within the Government. They stressed that, if they were were to do this, the consultation process would have to be much more meaningful than it has been so far. The State Department maintains, however, that several efforts to obtain specific information on the adverse economic effects of foreign policy controls have resulted for the most part in only general responses from the business community.

OTHER AVENUES FOR BUSINESS-GOVERNMENT CONTACTS

Although the administration did not have the benefit of information provided through active formal business consultations, it did receive business advice on export control issues through several forums well in advance of the Soviet and Libyan control actions. Through these forums, the administration was informed of business' basic objections to foreign policy controls but said the expected foreign policy benefits of controls overrode economic impact concerns.

And, although businesses expressed surprise at the imposition of these foreign policy controls, it was no secret several months before the controls were imposed that the administration had been reviewing U.S. relations with the Soviet Union and Libya. The administration had publicly revealed it was reassessing the previous administration's policy of allowing U.S. exports which could be used in supplying the Soviet pipeline to Europe; as it noted in the Commerce publication Business America of July 27, 1981:

> "the Administration continues to review U.S. policy on non-agricultural trade with the Soviet Union, particularly with regard to sales of so-called 'high technology' items. One issue to be decided in such a study is the degree to which U.S. suppliers of oil and gas equipment will be permitted to participate in Soviet energy development."

Nevertheless, in light of the Reagan administration's stated predisposition to remove U.S. barriers to exports and its removal in April 1981 of controls on grain and phosphates for the Soviet Union, business representatives say they just did not believe controls would be so sweeping.

A major forum of business-Government contact on U.S.-Soviet trade issues has been the Advisory Committee on East-West Trade (ACEWT), consisting of senior executives of leading corporations, banks, law firms, and universities, which meets quarterly to advise the Government on current trade issues.

Several months in advance of the December 30, 1981, controls, business representatives, through ACEWT, had been advising the Government of their essential criticisms of foreign policy export controls. At these meetings, the administration told business of its ongoing review of U.S.-Soviet energy-related trade, but it also sent some signals that it would not impose unilateral controls.

On March 9, 1981, in a formal letter to the Reagan administration, the Committee cited foreign policy economic sanctions as one of three major trade issues and advised that:

--Unilateral sanctions are ineffective in influencing Soviet foreign policy behavior because of the availability of alternate supply sources.

--Efforts to enlist the support of U.S. allies for tighter controls may have damaging long-term effects on allied relations; thus careful consultation with allies is needed in deciding on controls.

--Any U.S. control action might be locked in place despite its comparative ineffectiveness due to the possible political symbolism of revising U.S. policy.

In April 1981, at its first quarterly meeting with Reagan administration officials, the Committee discussed U.S. export control policies. Commerce's Assistant Secretary-Designate for Trade Administration said that the administration was reviewing its entire East-West trade policy and noted, with respect to foreign policy controls, that "unless the U.S. has a monopoly on a particular product, and can convince our allies not to substitute for what is being embargoed by the U.S., there is a real question as to how productive unilateral controls can be."

At ACEWT's next meeting, in July 1981, foreign policy controls were again discussed, including controls on oil and gas equipment to the Soviet Union. The Deputy Assistant Secretary of Commerce for Export Administration observed that the President was reviewing them, "including the option of dropping them," but cautioned that "there are many voices in the government on foreign policy controls and no one knows whether they will be dropped." He added that he personally did not favor foreign policy controls on an _ad hoc_ basis and that such controls are useful only if they are multilateral and can be applied effectively.

ACEWT's next meeting in October 1981 resulted in recommendations, dated November 27, 1981, to the Secretary of Commerce on East-West trade policy. In this memo the Committee advised that:

--To be effective, foreign policy controls must be multilateral and strongly supported by U.S. allies because of the availability of alternate supply sources; otherwise such controls serve only to hurt U.S. business.

--Soviet energy projects will be one of the major growth markets for Western exports of industrial goods.

--U.S. allies regard energy cooperation with the Soviet Union as a key component of their trading relationships, and their businesses are certain to compete aggressively for Soviet orders, given the inevitability that these projects will be constructed.

Although ACEWT did not give the administration detailed cost figures for exports and jobs lost as a result of these controls, at least a few major firms did give the Government some details about sales and jobs at stake in their exports for the Soviet gas pipeline.

Business representatives said they were also surprised at the June 22, 1982, extraterritorial extension of controls. Even though this kind of control had been discussed in the news media, in congressional hearings, and before ACEWT, representatives said they just could not believe the Reagan administration would take such drastic action.

During the 6 months between the December 1981 and June 1982 controls, businesses had made public their basic criticisms of the December controls. In addition, at an April 15, 1982, ACEWT meeting, business discussed with the administration the issue of extraterritorial application of U.S. foreign policy controls.

Since there was no trade advisory committee similar to the one on East-West trade, there was less opportunity for business-Government exchange on U.S. trade policy toward Libya. Nevertheless, the deterioration in U.S. political relations with Libya in 1981 and 1982 was evident to public observers. Major events during this period included the administration's closing of the Libyan diplomatic mission in the United States in May 1981; the Gulf of Sidra incident in August 1981, when U.S. jets shot down two Libyan aircraft after being fired on; the invalidation of American passports for travel to Libya in December 1981, which greatly affected many U.S. businessmen operating there; and the concern in early 1982 about Libyan terrorists operating in the United States. Some businessmen noted also that there had been longer delays in the fall of 1981 in getting licenses approved for export to Libya and that they suspected "something was up."

Other existing forums for business-government consultation are the President's Export Council and its Subcommittee on Export Administration and the 21 Industry Sector Advisory Committees (ISACs). The Council did register general business concerns over foreign policy controls during 1981-82, but the ISACs, with the exception of the Aerospace ISAC, did not focus on foreign policy control issues or provide cost information on the controls' effect. The Aerospace ISAC had actively volunteered its concerns over foreign policy controls but was not consulted before controls were imposed.

Even though these advisory committee meetings can serve as two-way exchanges of information and opinion on trade issues, they were not used to collect specific information on how proposed controls would affect individual businesses and industries. Committee membership is limited, members are cleared to discuss confidential materials, and many of their meetings are closed to the public. Therefore, only a small number of U.S. businesses have the opportunity to advise the Government and to hear of potential Government actions, and whatever confidential information the members receive cannot be disseminated outside the meetings.

Compiling accurate and complete information on the dollar costs of export controls has proved a very difficult task even now, many months after the imposition of controls. Some trade associations attempted to do such a study on the Soviet energy controls but found it extremely complicated and time consuming. The major difficulty is in assessing the long-term structural changes in U.S. trading patterns that may result from these controls, and this effect is what businesses are most concerned about.

PUBLIC COMMENT PROCESS

Another opportunity for business advice on the economic impact of controls is provided when Commerce solicits public comments immediately after controls are imposed and as part of the end-of-the-year controls extension process. In practice, however, the business community does not regard these public comment periods as meaningful opportunities to provide relevant information useful in the controls decisionmaking process.

During the interim public comment period (usually 60 days) between the initial announcement of controls and the intended issuance of the final regulations, businesses do have the opportunity to formally register their information and views on the impact of these controls. We found, however, that the extent and quality of the information that businesses are willing to provide during this stage is limited because they:

--Are reluctant to make public the detailed information on their expected losses.

--May not want the public to perceive them as siding with the unpopular target country, if they oppose the controls.

--May be aware of how politically difficult it is for the administration to reverse its announced and widely publicized decisions.

--May not be able to give details because they cannot predict how strictly Commerce will administer the regulations.

--Can only estimate potential future sales, and these figures are often perceived to be inflated.

In none of our case studies of control imposition did the information received during this interim period result in changes in the initial controls to take business interests into account.

During the end-of-the-year controls extension process, businesses are requested through a Federal Register announcement to publicly submit their comments. And, like the interim comments, businesses do not perceive this to be a meaningful process and do not make active use of this consultation opportunity. Commerce officials told us that they primarily use business comments in writing the annual report on export controls to the Congress. This information, of course, is available for use in reconsidering the controls; but the extension process requires State and Commerce agreement, and State is likely to argue that it is politically inadvisable to remove controls without accompanying advances toward the controls' initial foreign policy objectives. (See ch. 3.)

In our opinion, the public comment periods are not now meaningful opportunities for business to influence decisions on imposing or extending controls. In part, this reflects the limitations of the information coming from business, but to a much greater degree it reflects the overriding importance to the administration of the foreign policy purposes of the controls.

AGENCY COMMENTS

The State Department commented that the report does not take into sufficient account the constraints on public disclosure that policymakers face when considering economic sanctions. It stated that agency performance in consulting business should be judged in light of the prospect that premature public disclosure may in some cases vitiate the entire purpose of the sanctions. Commerce agreed with this point, noting that the element of surprise is essential for controls to have maximum impact. (See appendixes II and III.)

State and Commerce also noted that many public statements indicating the possibility of controls preceded each of the control impositions covered in the report and that the administration knew of the key objections of business, largely because of extensive informal consultations. State says it took the initiative to contact those businesses principally affected, except in some instances in which the businesses contacted State first. It added that little formal consultation took place largely because considerable information was already available to the Government from general trade data and from informal consultations and because firms are usually reluctant to provide hard data on pending business which might be lost as a result of controls. Commerce stated also that there was an effort in each case to discuss the controls with key firms or associations before they were imposed, even though these contacts were not as extensive or as timely as Commerce would have liked.

With regard to the usefulness of the public comment process, State and Commerce maintained that, on occasion, public comment periods have been meaningful consultation opportunities and that major changes have been made in the context of the extension process. In the case of the South African controls, they said the controls were revised to be more equitable and internally consistent as a result of comments received during this period.

CHAPTER 3

ADMINISTRATION ANALYSIS OF DOMESTIC

ECONOMIC EFFECTS

Despite the limitations of the information received through the business consultation process, Commerce and State staff did prepare analyses of the controls' direct export costs which were forwarded to the President or other decisionmakers prior to the imposition of controls. The administration had considered the Soviet and Libyan controls for several months before imposing them, and policymakers did have basic knowledge of the controls' expected domestic economic impact.

The economic impact analyses were not systematic studies formally outlining the various economic effects of the controls. In general, the administration did not have the data to assess all secondary effects of the controls--such as effects on future trade, subcontractors, jobs, and government revenues.

Economic analysis performed as part of the annual controls extension process is generally quite perfunctory. Once controls are imposed and announced publicly, it is very difficult to remove or relax them until some advances have been realized toward their foreign policy objectives.

INFORMATION TRANSMITTED TO DECISIONMAKERS

In three of our four case studies of new controls, some information on their economic impact was presented to administration decisionmakers prior to control action. In the fourth case, the limited-scope October 1981 controls on light aircraft to Libya, there is no record of such information going forward.

These economic analyses focused on direct export losses. Little or no information was provided on the effects on secondary U.S. suppliers, lost jobs or Government revenues, or on specific regions and communities. Very general comments were made on whether the controls might result in changes in trading patterns. The administration states that time, urgency and the need for secrecy preclude extensive outreach to the business community to more fully assess economic effects.

The Soviet controls

Although the December 30, 1981, controls on the Soviet Union were imposed in response to the imposition of martial law in Poland earlier that month, the administration had been considering revising export control policy on equipment and technology used in Soviet energy development throughout 1981 as part of contingency planning. A major concern of the U.S. Government during early 1981 was the increasing West European dependence on Soviet energy sources. An energy sub-group of the East-West

Economic Interagency Group developed background papers discussing the pros and cons of a range of options on export controls for the full Group's consideration, including the adverse effects that restrictions of varying stringency would have on U.S. business.

This policy review, occuring simultaneously with an overall State-Commerce review of all export controls in 1981, resulted in the referral to the President by October 1981 of the question of what action to take with regard to oil and gas equipment and technology export licensing. The President had not yet made a decision on the issue when the imposition of martial law in Poland gave him immediate cause for imposing new export controls.

In the 2-week period between the imposition of martial law in Poland and the U.S. decision to impose controls, an ad hoc group headed by NSC staff developed a wide range of options for response to the Polish repression. Commerce analysts prepared information on the domestic economic impact of each option. Five days prior to the December 29 announcement of control action, Commerce informed the NSC that halting exports of oil and gas equipment would cost the U.S. economy about $210 million a year. This estimate was based on the value of licenses issued for oil and gas equipment during 1981, augmented by knowledge of major upcoming sales. Commerce also noted that $80 million worth of oil and gas technology exports to the Soviet Union were denied in 1981, but this amount was not included in the overall projection for 1982. In addition, Commerce noted that "the U.S. sells the best equipment, which the Soviets prefer," but that most of the equipment could be purchased outside the United States.

The Commerce memo transmitting this information mentioned the proposed controls' effects on a few companies. Also, we are aware of at least one major U.S. company affected by these controls that did specify to the White House in November 1981 the direct and secondary effects on exports and U.S. jobs that controls would have. The information available to decisionmakers on individual companies may have been greater than this, as we were told that many of the interagency communications regarding these controls during this late-December time period were verbal, with no record of all the information that was exchanged.

Like the December 1981 oil and gas controls, the June 22, 1982, decision to extend the controls extraterritorially was made after a lengthy debate within the administration that did include Commerce-generated information on the likely domestic impact of proposed actions. As early as January 25, 1982, the Commerce Department contributed economic impact analyses to interagency discussion of extraterritorial controls involving NSC, Commerce, and State, among others. Specific information on the losses that would be experienced by foreign licensees and subsidiaries of U.S. corporations was prominently featured in the analysis. By the end of February, Commerce had arrived at the quantification of damages that it would continue to use until the controls were lifted 10 months later. This information was included in a February 1982 Commerce interagency memo which estimated that extraterritorial applications of oil and gas export controls would cost foreign subsidiaries of U.S. firms about $200 million annually over the next 3 years and licensees as much as $1 billion in total sales of goods incorporating U.S. technology. Extensive information was included on the expected monetary loss to individual licensees and subsidiaries. The direct short-term loss to the U.S. parent firms would consist of foregone earnings from foreign subsidiaries and licensing fees. Commerce analysts stated that these could not be estimated with precision.

The memo also noted that the long-term costs to American business could be substantially higher because of damage to the U.S. reputation as a dependable supplier. The memo did not attempt to quantify the likely impact of perceptions of unreliability on U.S. sales, but it did note that:

> "the targets of the extraterritorial application of controls: licensing, investment, and other cooperative trade mechanisms, are important sources of revenue for the United States. In 1980 U.S. firms earned a total of $6 billion in fees and royalties and $37 billion in income from affiliates worldwide."

<u>The Libyan controls</u>

Despite the extremely short timeframe allowed for businesses to provide their comments before the March 1982 Libyan controls, the administration considered some sort of export control action several months before they were actually imposed.

At least as far back as October 27, 1981, the State Department, in cooperation with the Department of Commerce, provided information on the probable domestic impacts of a range of possible economic actions. At that time the State Department noted that U.S. exports to Libya in 1980 were valued at $509 million, "mostly for machinery and transportation equipment" and estimated that about half of this equipment was related to Libyan oil production. It was also noted that Libya imported few items from the United States that were not available from other sources and that the reputation of U.S. companies as reliable suppliers would be hurt if controls were adopted, not only in Libya but in other countries as well. The estimate of export losses noted above was drawn from the Census Bureau's monthly publication of Schedule E export statistics, which are based on Standard International Trade Classifications (SITCs).

By February, these figures had been updated to use 1981 data--informing policymakers that the total value of exports to Libya that year had been about $800 million, with about $200 million to $300 million of it in oil and gas equipment. A large portion of the gas equipment exports was attributable to one company.

It appears that the administration took some care in framing the controls to minimize their disruptive effects; for example, the controls did not apply extraterritorially nor did they generally affect existing contracts or bar exports of energy equipment and technology available from foreign sources.

Like our other case studies, the October 1981 controls on light aircraft sales to Libya were considered by State and Commerce for several months (since at least the previous July) before being imposed. However, records from the two agencies do not reveal any evaluation of the economic effects of the proposed controls prior to their imposition. The legislatively required report on the controls submitted to the Congress a week after their effective date stated only that the 1980 total value of U.S. small aircraft sales to Libya was $7.58 million. Although the controls were designed to prevent some sales while allowing others, no indication was given as to what portion of total sales would actually be prohibited. A "modestly negative" impact on the producing industry was predicted.

LIMITS TO IMPROVED ECONOMIC ANALYSIS

Important limits exist to the kinds of quantitative information available to Commerce staff analyzing the economic impact of controls. Some of these information-base weaknesses are difficult to correct without requiring major new resource commitments by Commerce and burdensome data submissions from business. Other weaknesses cannot really be remedied in terms of improving the quantification of adverse economic effects.

The basic constraints in Commerce's ability to quantify economic costs are the lack of readily available complete information on (1) exports in categories not subject to any export controls, (2) prospective export sales, (3) effects on subcontractors, and (4) foreign availability of foreign policy controlled items. In addition, it is extremely difficult to quantify the economic costs resulting from damage to U.S. exporters' reputations as reliable suppliers.

Commerce requires exporters to submit information on their overseas sales only for goods or data in categories subject to export controls; and even in those cases, private companies are not required to keep the Government apprised of all prospective export sales, who their subcontractors are, or what goods they purchase from them.

For goods and data already controlled, information on prior year sales--broken down into very specific categories--can be obtained from OEA files of license applications. For categories not subject to export controls, information can be obtained from the Census Bureau's monthly statistics on export trade, but not in such specific detail. This means that Commerce analysts can determine precisely the value of exports in the preceding year in categories for which licenses are already required, but their knowledge of the value of exports in discrete categories of uncontrolled goods will be less precise.

A good example of this situation is the December 1981 Soviet oil and gas controls. Commerce already had a validated license requirement in effect for exploration and production equipment and data. The new regulations embargoed exports in these categories and in the transmission and refinement categories. Commerce analysts said they had no trouble determining the total 1981 value of exports in categories already controlled but that Census export statistics for transmission and refining were not sufficiently detailed and they had to estimate the value of exports that would be affected by the new regulations. As it turned out, one high-level Commerce official told us, the value of sales in these categories was underestimated by a considerable margin.

Knowledge of upcoming major projects is also important in analyzing economic effects. When such information is known, it has been added to previous year trade statistics in developing economic cost estimates. Companies are not required to submit information on future sales, however, so it is difficult for Commerce analysts to obtain this information. Government knowledge of such future sales is spotty, being gathered from ongoing industry contacts, mention in trade publications, and inclusion on license applications for items already controlled.

Another constraint in Commerce's information base concerns the impact of export controls on subcontractors. As already noted, Commerce does not require exporters applying for licenses to submit information of this kind. In none of our case studies did we find evidence of analysis of the controls' effects on secondary suppliers.

A fourth, very important constraint in Commerce's information base concerns the foreign availability of items that may be subjected to export controls. Foreign availability is important in assessing both the effectiveness of proposed controls in denying exports to target countries and the economic impact of long-term losses of U.S. markets overseas. The EAA specifies that one factor to be considered before imposing foreign policy controls is "the probability that such controls will achieve the intended foreign policy purpose, in light of other factors, including the availability from other countries of the goods or technology proposed for such controls." To develop this information, EAA further specifies (in section 5(f)(5)) that the Secretary of Commerce shall establish within OEA a capability to monitor and gather information on the foreign availability of any goods or technology subject to export controls under the Act.

However, because funding was not available, Commerce has not developed a foreign availability assessment capability. The first funds were appropriated for this purpose in 1982, when $280,000 was used for external research contracts on developing methodologies and sources for foreign availability assessment. No funds have been appropriated since then, and OEA foreign availability staff presently includes only two full-time professionals. They have been occupied, on an ad hoc basis, with a limited number of cases in the national security control area. Since this staff was put into operation during March 1982, it could have been consulted on only one of our case studies--the June 1982 extraterritorial controls, an action this staff told us they were only peripherally involved in. In any case, it appears that a large resource commitment would be required to assemble a comprehensive foreign availability data base.

The most difficult adverse economic effect to quantify, and perhaps the most important to long-term U.S. export interests, is the impact of controls on the reputations of U.S. companies as reliable suppliers. Control actions may affect not only the willingness of particular foreign buyers to again depend on U.S. suppliers but also the disposition of all buyers in that country, and indeed around the world, to purchase goods that may be subject to U.S. export controls. U.S. companies may also decide to move production and research activities overseas to avoid U.S. controls. Such adverse effects can be extremely important but are impossible to quantify.

To have all the first four kinds of information on hand for possible future use in preparing economic analyses on export controls, the Government would have to require extensive data submissions from businesses not now subject to export controls. We do not believe this is desirable or realistic. The potential range of items subject to export controls is so extensive that Commerce would have to collect additional data on virtually all exported commodities.

An alternative to such extensive business reporting and Government expenditure is for Commerce to solicit, and accept at face value, more information from businesses likely to be affected by specific, proposed export controls; i.e., closer business consultation. As mentioned earlier, however, the administration is reluctant to formally consult business early in the decisionmaking process because the possibility of leaks could detract from the controls' effectiveness.

POSSIBILITIES FOR CLOSER COORDINATION OF ECONOMIC ANALYSIS

Within the Commerce Department there are some valuable sources of information which conceivably could improve the economic analyses before controls are imposed. Consideration of export controls is centered in the Office of the Deputy Assistant Secretary for Export Administration, subject to the authority of the Assistant Secretary for Trade Administration. This office gathers information to estimate the domestic impact of new controls mainly from two sources--the licensing divisions within OEA and the country desks under the authority of the Assistant Secretary for International Economic Policy.

OEA's industrial specialists in its licensing divisions--the Scientific and Electronic Equipment and Capital Goods and Production Materials Divisions--which are responsible for processing license applications, have developed expertise in their industries' export activities and were frequently asked to provide data for use in consideration of proposed export controls.

We found that the country desks were not always consulted. Analysts in the USSR Division informed us that they had prepared an appreciable amount of material on the economic impacts of a range of options prior to imposition of both the December 1981 and June 1982 controls on oil and gas equipment exports. In contrast, the Libyan desk had little analytic input before export controls were imposed in October 1981 and March of 1982.

Another source of possibly useful trade expertise within the International Trade Administration (ITA) is the Office of the Assistant Secretary for Trade Development. Its employees have extensive knowledge of the export activities of their assigned industries and could provide additional insights into the effects of proposed controls. However, there is no formal system for obtaining input from them and their involvement in the process has been minimal.

Finally, outside of ITA but still within Commerce is another potentially valuable resource for estimating economic effects--the Bureau of Industrial Economics. One of its tasks is to maintain continued awareness of all aspects of individual industries, including international trade patterns. Yet, Bureau officials told us they were not consulted on any of the controls comprising our case studies. One analyst said they could have provided good information on existing contracts, some potential contracts, U.S. jobs lost, and effects on secondary suppliers.

OEA recognized the desirability of maximizing use of Commerce Department expertise in a January 1983 draft memo which requested the assistance of ITA's Assistant Secretaries for International Economic Policy and Trade Development and the Bureau of Industrial Economics in preparing economic analyses for the 1983 renewal. It stated:

> "We need your assistance in assuring that the analysis accompanying the January extension of controls is as thorough as possible. In the past, we have relied heavily on comments volunteereed by industry, informal contacts with key firms in affected industries and ad hoc requests for contributions from ITA economists and area desks. This method has been inadequate to provide a thorough analysis."

Revisions in controls on South Africa: economic effects vs. political symbolism

The revision of the Carter administration's very broad foreign policy export controls on South Africa is a case where (1) the importance of adverse effects on U.S. exporters was a primary reason for relaxing the controls and (2) the political difficulties of revising the controls without accompanying advances toward their foreign policy objectives hindered the decision.

Because these controls applied to exports which directly or indirectly might reach the South African military or police, they affected a broad spectrum of U.S. exports, including such commonly available items as toothpaste and soft drinks.

Businesses were surprised when the controls were first imposed, and they immediately began raising questions on how they would be affected. Major business criticisms of the 1978 and 1979 controls focused on the:

--Broad and vague language, which allowed varied interpretations and inconsistent applications.

--Difficulties in knowing whether an export might end up in the hands of the police or military and the inequities for U.S. exporters that sought to identify the end users for their exports versus those that made no effort to do so.

--Availability from foreign sources of most of the commodities and data covered by this unilateral embargo and the consequent loss of important South African markets to European and Japanese suppliers.

--Damage to U.S companies' reputations as reliable suppliers.

--Damage to relations with friendly third countries due to application of controls to foreign-manufactured products containing U.S.-origin parts.

These controls were imposed in February 1978, before Congress revised the EAA to require business consultations and economic impact analyses, and no formal study has been made to measure the controls' export costs. Overall trade statistics do show a sharp decline in the U.S. share of a growing South African market immediately after the controls were imposed--the U.S. share fell from 19.1 percent in 1977 to 13.8 percent in 1980, despite growth in U.S. exports of almost 130 percent.

Less than a year after the 1978 controls were imposed, Commerce and State officials discussed the issues raised by the controls and the queston of whether they might be modified to alleviate the problems of U.S. exporters. No changes were made because the Secretary of State decided that "any modifications of the regulations would be detrimental to our broader objectives in southern Africa* * * [and] * * * that any shift in our policy on this issue now could damage our efforts * * * to reach an internationally acceptable settlement in Namibia."

During the review process for extending controls through 1980, Commerce recommended to the President that the regulations be revised, on a case by case basis, to permit exports of products and technical data intended primarily for use in the civilian sector. President Carter, however, rejected this recommendation. The 1980 Commerce-State review process also resulted in extending without change existing controls as well as expanding controls to embrace low-performance computers destined for the government. Reasons given for these actions were the absence of movement toward fundamental social and political change in South Africa, the importance of the controls as a "unilateral declaration of U.S. unwillingness to aid and abet the South African Government policy of institutionalized racial discrimination," and the wish to avoid sending the wrong signals to other African countries.

With the change to the Reagan administration came both a new policy of "constructive engagement" toward South Africa and an extensive review starting in the summer of 1981 of all existing foreign policy controls. Virtually throughout this 1981 interagency review process, Commerce argued for more changes than State, which noted in late 1981 that:

> "The Commerce proposals are viewed by State as the ideal to work towards rather than as a first step * * * Trade Controls should be rationalized in tandem with and in response to an improvement of U.S. South African relations, i.e., progress toward the twin objectives of Namibian independence and internal reform."

Disagreements between the two departments persisted throughout the extension review process, which lasted through February 1982.

Various compromises were made between State and Commerce, and the review process, in fact, resulted in the decontrol of numerous exports to South Africa, as described in chapter 1. The administration said these changes were to focus the controls' effect more clearly and specifically "on the objectives of the controls"--i.e., items directly related to apartheid.

COMPENSATION FOR ADVERSE ECONOMIC EFFECTS

Administration officials told us that they have given no consideration to compensating firms, employees, or communities for the adverse effects of foreign policy export controls because there is no authorization in the EAA to do so.

Proposals for providing such compensation have arisen recently as part of the debate on the reauthorization of the EAA. (Existing agricultural legislation already provides for compensation for agricultural embargoes.[1]) The business community disagrees within itself on the desirability of requiring compensation for industry costs incurred as the result of export controls.

Proponents of compensation argue that specific sectors of the U.S. economy should not bear the costs of actions taken for national foreign policy purposes. Compensation provisions would force the Government to acknowledge and pay the costs of controls. Presumably, this would deter the use of export controls as an easy-choice foreign policy tool.

Opponents of compensation focus on the difficulties in calculating lost exports and jobs. They argue that compensation schemes can never compensate for such likely but inestimable effects as

--disruption of contracts under negotiation for several years but not actually signed when controls are imposed;

--follow-on sales of spare parts and related materials, which can amount to more than the original contracts;

--basic, structural changes in world trade patterns resulting from European and Japanese suppliers replacing U.S. exporters in world markets; and

--damage to U.S. companies' reputations as reliable suppliers.

Some business groups also argue that compensation for lost contracts might actually make it easier to impose controls. Most business groups consider a provision guaranteeing sanctity of contracts to be more important than one providing compensation. They reason that compensation would be unnecessary if the Government intends to observe a sanctity of contracts provision.

AGENCY COMMENTS

State concurred with the report's observation that more economic analysis will not alter decisions made. It also stressed that most of the economic information-base weaknesses are inherent and cannot be corrected even with major new resource commitments and data submissions from business.

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[1]Some information on existing U.S. and foreign compensation programs is provided in "Interagency Structure of Economic and Foreign Policy Decisionmaking," (ID-83-41, May 12, 1983).

Commerce noted that any discussion of the economic costs of sanctions needs to be balanced against an assessment of the foreign policy and commercial gains to the United States and its allies. With respect to the Soviet pipeline sanctions, Commerce claims that export opportunities were created for U.S. coal producers and oil, gas, and nuclear equipment manufacturers which would benefit from the allies' agreement, in the wake of these sanctions, to accelerate development of potential Western energy alternatives to Siberian gas.

Commerce also commented, with respect to the Soviet controls, that the June 1982 amendment was intended to restore both equity and effectiveness to the December 1981 controls by extending them to U.S. persons and licensees abroad. As Commerce noted, the December 1981 controls applied only to U.S. companies and foreign-based firms using U.S.-origin technical data; thus the economic burden of the controls was disproportionately borne by a few U.S. companies. The June 1982 amendment, according to Commerce, improved the December 1981 controls' effectiveness and restored equity in burden-sharing among the allies.

Unfortunately, this effort to obtain broader input for the 1983 extension was made too late in the review process to be practicable, and the memo was not forwarded. A responsible OEA official told us that a similar effort will be undertaken for next year's renewal. Such an approach, in our opinion, could at least marginally improve economic analyses.

ROLE OF ECONOMIC ANALYSIS IN THE ANNUAL EXTENSION PROCESS

The EAA requires that foreign policy controls expire one year after imposition unless extended by the President in accordance with the six criteria, including economic impact, required for initial imposition of controls. It also requires the President to submit to Congress a report listing his conclusions concerning each criteria whenever controls are extended. These requirements result in an annual review process, usually from October to December, during which State and Commerce decide which controls should be extended without change and which should be altered or removed. Most of the negotiations are carried out at the Deputy Assistant Secretary level, but the Secretary of Commerce retains authority to make the final decision and to sign the report to the Congress.

Perfunctory analyses

In practice, this annual review generally has been perfunctory and, with the exception of the South African controls, has produced only minor changes. It does not represent a continuing effort to monitor adverse economic effects. ITA analysts are asked to contribute information to the OEA, and business comments are solicited through a Federal Register announcement. Analysts receive minimal guidance on how to assess economic impact, such as the controls' effects on secondary suppliers or lost jobs and revenues in affected communities. In recent years, Presidential management interns were used on short-term assignments to assemble information for the annual reports and no one was assigned to monitor economic effects during the rest of the year. For the report extending controls through 1983, not even a management intern was made available. The information received in this process is summarized and presented in the annual reports to Congress. However, the information has little effect on decisionmaking, and controls have generally been renewed without change.

When the Reagan administration assumed office in 1981, however, its initial review of the controls inherited from the previous administration was unusual in its thoroughness. It was more of an overall review of the need for foreign policy controls, and it did result in significant changes in the export controls on South Africa.

CHAPTER 4

OBSERVATIONS

The foreign policy export control decisions we reviewed had been contemplated by the administration several months before the controls were actually imposed, despite the public appearance of having been made in quick reaction to Soviet and Libyan actions. Administration decisionmakers did have economic cost data based on direct export sales to be lost but did not generally have information on secondary economic costs, such as effects on subcontractors, future sales, employment, and Government revenues. Formal business consultation was either nonexistent or minimal; but ongoing business-Government discussions in the months before the imposition of controls did inform the administration of business' key economic arguments against the use of foreign policy export controls and of the controls' effects on individual companies in at least a few important cases. The administration thus made its decisions despite its knowledge of basic economic costs and business objections and cited the controls' foreign policy purposes as its overriding concern.

Changing the EAA to try to improve decisionmaking is possible, but implementation of these changes is likely to be extremely difficult and to have limited benefits. For example, requiring additional data collection and economic analyses and setting guideposts concerning the tolerable level of economic costs that might be incurred for potential foreign policy benefits is unlikely to improve decisionmaking because of constraints on data collection and analysis and the predominance of foreign policy considerations. Improving the end-of-the year economic analyses made as part of the controls extension process also probably would have only marginal value, given the importance that demonstrated progress in meeting foreign policy goals plays as the primary justification for relaxing controls. There is potential for revising the law to reduce the burden on the private sector through provisions safeguarding contract sanctity or limiting extraterritorial reach. However, such changes address only part of the basic problem of damage to U.S. companies' reputations as reliable suppliers and the resulting long-term structural changes in U.S. trade patterns.

Other possible changes would not necessarily contribute to better decisionmaking as a general proposition but could reduce the use of foreign policy export controls by restricting them or making them more cumbersome to use. Improving Commerce's foreign availability assessment capability and prohibiting the use of controls where foreign availability exists would, in effect, greatly reduce the President's ability to use export controls as a foreign policy tool. And requiring a public comment period before controls could be imposed would have a similar effect, because it is unlikely a President would want such a decisionmaking process conducted publicly.

In our view, the key problem with foreign policy export controls is that their economic costs are perceived by the U.S. business community to have been more visible than their political benefits, yet their foreign policy rationale has consistently predominated. By demonstrating that the administration did know the essential economic arguments against the use of export controls, our review helps to clarify the debate on foreign policy controls, in the sense that it refutes the premise that the administration might have acted differently had it been aware of the probable economic costs, and it shifts the debate back to the usefulness of such foreign policy controls.

If the Congress believes it is desirable for the President to have this kind of foreign policy tool, then it will have to rely on the judgment of the President to impose controls as he sees appropriate. We do not believe that fine tuning the Act to require more economic analysis will alter the decision made. On the other hand, if the Congress believes, as U.S. major trading partners do, that unilateral foreign policy export controls are not an appropriate tool to achieve foreign policy goals, then its alternatives are to limit or remove this authority from the Act.

CHARLES H. PERCY
ILLINOIS

United States Senate

WASHINGTON, D.C. 20510

October 26, 1982

Mr. Charles A. Bowsher
Comptroller General of the United States
General Accounting Office
441 G Street, N.W.
Washington, D.C. 20548

Dear Chuck:

The 1980 grain embargo against the Soviet Union and the present sanctions aimed at oil and gas technology exports to the U.S.S.R. have raised questions about the extent to which the Federal government fully evaluates the impact of these decisions before they are made.

Under present law, the President is required to make certain assessments before imposing foreign policy export controls. For example, he is directed under the Export Administration Act to evaluate several criteria before imposing export controls, including:

- the probability that controls will achieve their intended purpose;
- the foreign availability of the goods and services to be controlled;
- the effect of the controls on the U.S. competitive position in international commerce;
- the extent to which the controls would affect our reputation as a reliable supplier of goods and technology; and
- the ability of the Federal government to enforce the controls.

In addition to these specific criteria, the President is directed to consult with affected U.S. industries and with Congress before imposing the controls.

These specific criteria were placed in the law for good reason and yet they do not appear to have mitigated recent export controls which have proven very damaging in the short-run to the American economy.

Certainly the President must have the necessary authority to make national security decisions. I do not question that fundamental. Rather, I question the extent to which economic consequences are seriously considered prior to the imposition of foreign policy export controls.

Moreover, I would like to know what policy analyses are conducted by the Federal government with regard to sectors of the economy penalized by export controls. Have administrations considered special tax relief or procurement for companies affected? Indeed, to what extent would international agreements allow for the implementation of such special policies? In short, has the Federal government considered Trade Adjustment Assistance-type programs for injured industries and if so, why has this recourse been rejected?

I would greatly appreciate any assistance you and your staff could provide with regard to these questions. I know Senator Abdnor and other Senators share my interest in this matter and your evaluation would lay an important foundation for next year's review of the Export Administration Act.

Thank you for your consideration and attention.

Warm personal regards,

Charles H. Percy
United States Senator

CHP:aeb

(483379)

UNITED STATES DEPARTMENT OF COMMERCE
The Inspector General
Washington, D.C. 20230

AUG 8

Mr. J. Dexter Peach
Director, Resources, Community
and Economic Development Division
U. S. General Accounting Office
Washington, D. C. 20548

Dear Mr. Peach:

This is in reply to your letter of June 24, 1983, requesting comments on the draft report entitled "Administration's Knowledge of Adverse Economic Effects of Foreign Policy Export Controls."

We have reviewed the enclosed comments of the Under Secretary for International Trade, and believe they are responsive to the matters discussed in the report.

Sincerely,

Sherman M. Funk
Inspector General

Enclosure

GAO note: Page references in this appendix refer to our draft report and may not correspond to the pages of this final report.

UNITED STATES DEPARTMENT OF COMMERCE
The Under Secretary for International Trade
Washington, D.C. 20230

JUL 29 1983

Mr. J. Dexter Peach, Director
Resources, Community, and Economic
Development Division
United States General Accounting Office
Washington, D.C. 20548

Dear Mr. Peach:

Secretary Baldrige has asked me to thank you for the opportunity to review and comment on your draft report on "Administration's Knowledge of Adverse Economic Effects of Foreign Policy Export Controls."

Generally, we found the report constructive and balanced and we hope our written comments will further improve the final report.

We look forward to reviewing the final report when it is available.

Sincerely,

Lionel H. Olmer

Attachment

COMMENTS ON DRAFT REPORT:

Administration's Knowledge of Adverse Economic Effects of Foreign Policy Export Controls

Page iii, first paragraph - That consultations were not more extensive with business prior to imposition of controls was due not only to fear of news leaks but also to concern that the Soviets would obtain enough information to undertake active measures aimed at discrediting or neutralizing the sanctions. The element of surprise is essential if export controls are to have maximum impact.

Page iv, last paragraph - The heading should be changed to read:

> "Adequate U.S. Government Analyses of Economic Impact Were Transmitted to the Decisionmakers."

Page v, first complete paragraph - The report should refer to the costs and burdensome regulatory requirements of extensive data collection requirements designed to measure the "ripple effect" of sanctions, as described on page 31. The business community most likely would resist institution of a reporting system for trade not covered by validated license requirements.

Page 9, first paragraph - The report states that, "In three of our four case studies, the Secretary did not carry out the business consultation encouraged by the law...." On the contrary, there was an effort in each case to discuss the controls with key firms or associations before they were imposed. The Libyan controls on light aircraft were discussed by telephone with the General Aviation Manufacturers Association (GAMA), which obtained valuable information from its members. The two Soviet oil and gas actions were preceded by telephone contact with firms that would be affected most severely. I would agree that these contacts were not as extensive or as timely as we would have liked but they did occur.

Page 13, first paragraph - Add a fourth separate rationale:

> "-- the need to frustrate a well-developed Soviet campaign designed to circumvent the use of sanctions by the U.S."[1]

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[1] Such Soviet actions are documented in classified reports.

Page 16 - The report mainly cites reasons why the business community thought the Administration did not intend to apply unilateral sanctions against the USSR. It fails to note that U.S. companies had ample warning concerning President Reagan's serious reservations about whether the Siberia-West Europe natural gas pipeline should be built. At the Ottawa Summit in June 1981, the President voiced his doubts to the leaders of Western Europe. The Assistant Secretary of Commerce for Trade Administration was quoted on the front page of the New York Times in mid-January 1982, to the effect that the pipeline represented a "noose" around the economies of Eastern and Western Europe. Meyer Rashish, then Under Secretary of State for Economic Affairs, testified before Congress on the need, under certain circumstances, to impose strong unilateral foreign policy controls. That such controls were finally imposed should have come as no surprise.

Page 22, last paragraph - We accept the basic premise that public comments are unlikely to influence decisions to impose or extend controls. These comments have been most helpful, however, in identifying ways in which controls should be relaxed (e.g., South Africa), and in pinpointing inconsistent or unworkable portions of the regulations that should be revised. Mention of these benefits in the report would be useful in pointing out the advantage to affected firms of submitting comments.

Page 24, The Soviet Controls - The report lacks a discussion of steps taken by the Administration to modify the oil and gas controls imposed in December 1981, in order to: (1) improve their effectiveness; and (2) restore equity in burdensharing among the Allies.

The December 1981 controls applied only to U.S. companies and foreign-based firms using U.S.-origin equipment and components. As a result, the Soviets had access to essential equipment (gas turbines) for the pipeline from alternative suppliers using U.S.-origin technical data. In addition, the economic burden of the controls was disproportionately borne by few companies.

The June 1982, amendment to the controls extending them to U.S. persons and licensees abroad, was intended to restore both equity and effectiveness to the sanctions. Throughout the period in which the oil and gas controls were enforced, the application of Temporary Denial Orders (TDOs) was carefully limited to minimize the impact on the non-oil and gas business. Commerce maintained close contact with affected firms so as to enforce the controls fairly and with the least interruption of commercial contracts.

President Reagan's November 1982, decision to drop the expanded controls on oil and gas equipment was based on an understanding among the Allies to initiate discussions in I.E.A. COCOM, NATO, the O.E.C.D. on a wide range of East-West trade issues and to substitute for the sanctions longer-term policies on trade with the USSR designed to limit credit subsidies, avoid undue dependence on Siberian natural gas, and tighten controls on exports of advanced technology including that used in the oil and gas sector. Following the President's decision, all U.S. and foreign companies were free to fulfill contracts interrupted by the December 1981 and June 1982 controls.

Page 35, first complete paragraph - The report should also note the future gains to U.S. and other allied businesses in overseas sales of coal and energy equipment made possible by the Allies' agreement to accelerate development of potential Western energy alternatives to Siberian gas. The USSR clearly intends to use excess capacity in its natural gas export pipeline network to undercut the economic viability of western energy projects and, instead, increase Europe's dependence on Soviet gas. Only decisive action by President Reagan prevented this outcome, protecting Western energy security and preserving export opportunities for the coal producers and oil, gas and nuclear equipment manufacturers.

Page 36, last paragraph - We disagree with the statement that "....this annual review is generally perfunctory and produces only minor changes." "Granted, we have not had the resources to mount a "continued effort" to monitor economic effect. Nevertheless, even in the previous Administration, there were serious efforts to revise the controls in response to economic burdens; these efforts ultimately did not prevail. The two reviews conducted by this Administration have been both thorough and productive. In fact, the report due at the end of 1981 was delayed two months to resolve difficult issues. These two reviews resulted in significant modification of both the anti-terrorism controls and the South African controls.

Page 38, first paragraph - The draft states that "the total embargo on exports to the South African military and police placed a heavy burden of license applications on Commerce staff." Actually, very few license applications were received. An announced policy of total denial tends to discourage applicants. In this respect, the South African controls were distinctly different from the Libyan controls, where a broad range of items was made subject to validated license, but with a presumption for approval. We suggest you delete this phrase.

Page 43, Observations - We concur entirely with the first paragraph. The rest of the section, however, suggests that: (1) "reforms" in the use of foreign policy controls are not feasible; (2) the economic costs of foreign policy controls have been more visible than the political benefits; and (3) serious consideration should be given to eliminating Presidential authority to impose foreign policy controls.

We fail to see any evidence in the body of the report to support these generalizations. Indeed, the GAO at the outset concedes the report did not examine the "effectiveness of unilateral controls in achieving their stated objectives..." (p. ii).

Any discussion of the economic costs of sanctions deserves to be balanced against an assessment of the foreign policy, security and commercial gains to the U.S. and its allies. In the absence of oil and gas controls, not only might the repression in Poland have been far more intense, but the West's energy security positions would have been significantly weakened.

In short, we believe a discussion of the usefulness of controls, taking into account the foreign policy, security and commercial gains to the alliance, is an integral part of any cost/benefit assessment of their impact on business. We would be pleased to cooperate with GAO in preparing such a report.

DEPARTMENT OF STATE
Comptroller
Washington, D.C. 20520

22 JUL 1983

Dear Frank:

I am replying to your letter of June 24, 1983, which forwarded copies of the draft report: "Administration's Knowledge of Adverse Economic Effects of Foreign Policy Export Controls."

The enclosed comments on this report were prepared by the Director in the Office of East-West Trade, Bureau of Economic and Business Affairs.

We appreciate having had the opportunity to review and comment on the draft report. If I may be of further assistance, I trust you will let me know.

Sincerely,

Roger

Roger B. Feldman

Enclosure:
As stated.

Mr. Frank C. Conahan,
Director,
National Security and
International Affairs Division
U.S. General Accounting Office,
Washington, D.C. 20548

GAO DRAFT REPORT: Administration's Knowledge of Adverse Economic Effects of Foreign Policy Export Controls

The Department of State concurs with the general thrust of the subject report, namely, that more economic analysis will not alter decisions made. However, there are several general and additional detailed comments which the report overlooks. The overall points are, first, that the report does not take into sufficient account the very real constraints on public disclosure that policy-makers face when considering the implementation of economic sanctions. Agency performance in consulting business should be judged in light of the very real prospect that premature public disclosure may, in some cases, vitiate the entire purpose of the sanctions. Secondly, the report concludes at the bottom of page 44 that the economic costs of economic sanctions have been more visible than their political benefits. It ought to be repeated at this point in the text that the report does not attempt to judge the political effect of sanctions.

Chief among the points of detail is the role played by the Department of State in consulting with business concerning the economic effects of foreign policy export controls and in analyzing and drawing conclusions from information on these effects. The comments which follow are keyed to the page number in the draft:

Page iii lines 1-5: The Administration knew key objections largely because of extensive informal consultation with businesses, although the business consultation which took place before foreign policy controls were imposed was, for the most part, informal. The Department of State took the initiative to contact those businesses principally affected, except in some instances in which the businesses sought out the Department.

Page iv lines 1-5: Decisionmakers were not reluctant to consult more actively and earlier with business because of concern over the possibility that leaks to the news media would reduce the controls' foreign policy effectiveness. Indeed, decisionmakers actively sought the views of business. It was, of course, not possible to inform business of the form of controls to be considered until the decision had been made on that point. However, many public statements indicating the possibility of controls preceded each of the impositions of controls described in the report. Indeed, knowledge by affected parties of the possibility of controls often contributes to the effectiveness of the control process and sometimes makes the actual imposition of controls unnecessary.

GAO note: Page references in this appendix refer to our draft report and may not correspond to pages of final report.

Page 1 line 3: The statutory criteria are to be considered prior to the imposition of controls; they do not in any formal sense "govern" the imposition of controls.

Page 3 line 13: The State Department primary responsibility for assessing the impact of proposed controls is limited to the impact abroad. As the report points out elsewhere, Commerce has primary responsibility for assessing the domestic economic impact of proposed controls. However, State is actively concerned with promoting exports in furtherance of our foreign policy and other interests.

Page 4 last line: The 1980 Summer Olympics-related controls were allowed to lapse on January 20, 1983.

Page 5 lines 16-17: The June 1982 controls expanded those affecting foreign-made products of previously transferred U.S. technical data. The transfer of the data to other Western countries was not itself subjected to a validated license requirement.

Page 8 line five: The March 1982 revision did not permit "all" other goods and data to be exported (as recognized in the fourth tic). It did permit other goods and data not subject to security controls to be exported if they would not have contributed significantly to military or police functions.

Page 8: As a supplement to the last paragraph, items controlled for crime control or nuclear non-proliferation reasons joined items controlled for national security as banned from sale to police or military entities.

Page 9 last four lines: The Administration did not engage in more formal business consultation because it had obtained sufficient information informally to understand the economic effects reasonably well. Also, see comment above re page iv.

Page 10 line four: Public comment periods have, on occasion, been meaningful consultation opportunities. The South African controls were revised to be more equitable and internally consistent as a result of comments received during such a period.

Page 10 line 16: The Administration actively consulted with affected businesses on a continuing basis, although formal consultations were not possible until after specific controls had been approved in principle.

Page 12 lines 6-9: State was unaware that it "could not give definite answers to several important questions raised" and cannot comment on this point without knowing what the questions were which others thought could not be answered definitely.

Page 12 last paragraph: The controls had already been refined in anticipation of business and Allied government criticism.

Page 13 line 3: Significant informal consultation was carried out prior to export control action. Little formal consultation took place largely because the considerable information was already available to the government from general trade data and from informal consultations and firms are usually reluctant to provide hard data on pending business which might be lost as a result of controls.

Page 14: Government representatives were much aware of all of these risks for both the Soviet and Libyan controls. An expeditious procedure has been developed for the processing of the vast majority of Libyan cases.

Page 14 last two lines: See comment re page 12 lines 6-9.

Page 15: Several efforts to obtain specific information on the adverse economic effects of foreign policy export controls, for example in connection with a major study of export disincentives, have resulted for the most part in only general responses from the business community.

Page 22 first paragraph: See comment on page 10 line 4.

Page 22 end of second paragraph: The extension process may not take place at a time when a revision in the controls would be consistent with foreign policy objectives. However, major changes in controls have been made in the context of the extension process.

Page 25 line 1: The paper prepared after the imposition of martial law in Poland drew on policy options prepared during the previous year as part of extensive contingency planning.

Page 29 lines 3-5: See comment re page iv.

Page 31 last sentence: Most of the information-base weaknesses are inherent and could not be corrected even with major new resource commitments and burdensome data submissions from business.

Page 32 first paragraph: The basic constraints stem from the inevitable lack of complete information on the enumerated points and the impossibility of quantifying, except in very general terms, the economic costs resulting from damage to U.S. exporters' reputations as reliable suppliers.

Page 35 nine lines from the bottom: Even with extensive data submissions from businesses, the government would not "have all the first four kinds of information on hand."

Page 36 first four lines: The Administration cannot seek data on specific controls until decisions are made to consider such controls and, even then, business representatives often do not react specifically until they know that the specific controls are actually in effect.

Page 37 next to last line: For several years symbolic reasons had hindered revision in the South African controls. However, in 1981-83, the Administration determined that the political objectives of these controls would not hinder practical steps to revise them in ways unrelated to those objectives.

Page 38 lines 4-5: There have been very few license applications for items which, under licensing policy, would clearly be denied.

Page 38 penultimate line: No formal study was published at that time; but informal studies had been conducted.

Page 41 line 6: Some elements of the business community have advocated compensation.

Page 43 lines 3-4: Given numerous public statements envisaging the possibility of controls, there is little basis to state that there was a public appearance of having made the decisions very quickly.

William A. Root
Director
Office of East-West Trade

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