

GAO

Report to the Committee on Foreign
Affairs, House of Representatives

September 2010

DEFENSE EXPORTS

Reporting on Exported Articles and Services Needs to Be Improved



GAO

Accountability * Integrity * Reliability



Highlights of [GAO-10-952](#), a report to the Committee on Foreign Affairs, House of Representatives.

Why GAO Did This Study

The U.S. government exports billions of dollars of defense articles and services annually to foreign entities, generally through direct commercial sales (DCS) from U.S. companies under licenses issued by the State Department (State) or through the Department of Defense (DOD) Foreign Military Sales (FMS) program. GAO has previously reported on weaknesses in the export control system. As requested, GAO (1) identified the magnitude and nature of defense articles and services exported and (2) assessed information currently reported on defense exports and any gaps and limitations in defense export data.

To conduct this work, GAO analyzed export data from DOD for FMS and the Department of Commerce's U.S. Census Bureau (Census) for DCS for 2005 through 2009; reviewed relevant laws and regulations; assessed State and DOD reports on defense exports; reviewed agency data systems documentation; and interviewed officials from State, DOD, Homeland Security, and Census.

What GAO Recommends

GAO suggests that Congress consider whether it needs specific data on exported defense services and is recommending that State publicly report consolidated defense export data on DCS and FMS in a consistent manner. In the absence of additional direction and resources from Congress, State did not agree. GAO believes the recommendation remains valid.

[View GAO-10-952 or key components.](#)

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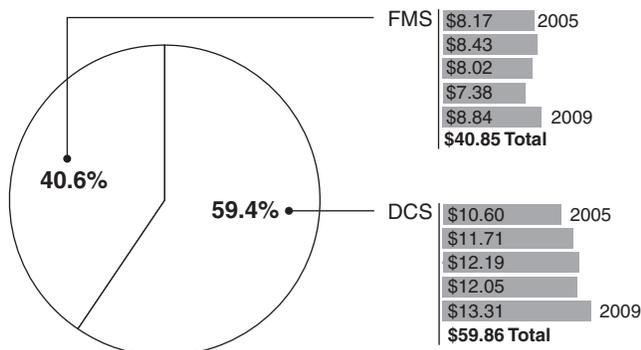
DEFENSE EXPORTS

Reporting on Exported Articles and Services Needs to Be Improved

What GAO Found

U.S. exports of defense articles—such as military aircraft, firearms, and explosives—ranged from about \$19 billion to \$22 billion annually in calendar years 2005 to 2009. Of these defense articles, about 60 percent have been exported by companies to foreign entities through DCS licenses, while the remaining 40 percent were exported under the FMS program. Aircraft and related parts constitute the largest category of such exports—about 44 percent—followed by satellites, communications, and electronics equipment and their related parts. U.S. exports of defense articles were concentrated in a few countries: about half went to Japan, the United Kingdom, Israel, South Korea, Australia, Egypt, and the United Arab Emirates. Although no data are available on the export of defense services—such as technical assistance and training—provided through DCS, exports of defense services through FMS were stable, accounting for about one-third of the value of FMS exports.

Exports of Defense Articles through Direct Commercial Sales and Foreign Military Sales, Calendar Years 2005 through 2009



Source: GAO analysis of DOD and census data.

Note: All values in billions adjusted to 2009 constant dollars and may not add to total due to rounding.

Congress does not have a complete picture of defense exports under current reporting—including which method of export is used more often by individual countries or for certain types of items. State—which has overall responsibility for regulating defense exports—and DOD, report to Congress in response to various requirements. However, their annual reports on DCS and FMS exports have several information gaps and inconsistencies—in part, because of the differing purposes of the agencies' data systems and different reporting methodologies. For example, State does not obtain data from U.S. companies on the export of defense services under DCS licenses, although it authorizes several billion dollars of such exports annually. State officials noted that they do not have an operational requirement to collect such information and doing so could be burdensome on exporters. Other limitations on defense export data include differences in agencies' item and country categorizations and the inability to separate data on some permanent and temporary exports. Further, while State's report is available on its Web site, DOD's is not. These differences and limitations may inhibit congressional oversight and transparency into the entirety of U.S. defense exports.

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Abbreviations

AES	Automated Export System
CBP	U.S. Customs and Border Protection
DCS	direct commercial sales
DDTC	Directorate of Defense Trade Controls
DOD	Department of Defense
DSCA	Defense Security Cooperation Agency
FMS	Foreign Military Sales
ITAR	International Traffic in Arms Regulations
USML	United States Munitions List

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United States Government Accountability Office
Washington, DC 20548

September 21, 2010

The Honorable Howard L. Berman
Chairman
The Honorable Ileana Ros-Lehtinen
Ranking Member
Committee on Foreign Affairs
House of Representatives

Each year, the U.S. government exports billions of dollars of defense articles and services, such as military aircraft and related parts, firearms, explosives, technical assistance, and training, that may include critical technologies. The government views the export of these articles and services as an integral part of safeguarding U.S. national security and furthering U.S. foreign policy objectives. Over the last decade, we have reported on weaknesses in the effectiveness and efficiency of government programs designed to protect critical technologies, which were largely attributable to poor coordination among multiple U.S. government agencies, complex interagency processes, and a lack of information sharing that together contributed to export enforcement challenges. These findings, along with others, prompted us to include the U.S. arms export control system as part of a high-risk area on ensuring the effective protection of technologies critical to U.S. national security interests since 2007.¹

The Department of State (State) regulates defense exports for consistency with national security and foreign policy interests. Eligible foreign entities² can obtain U.S. defense articles and services through the Department of Defense (DOD) Foreign Military Sales (FMS) program or through direct commercial sales (DCS) from U.S. defense companies under export licenses issued by State.

¹ GAO, *High-Risk Series: An Update*, [GAO-07-310](#) (Washington, D.C.: January 2007).

² Eligible foreign entities can include foreign governments, corporations, as well as international organizations, all of which are defined as foreign persons under 22 C.F.R. § 120.16. In addition, the Foreign Military Sales program is limited to eligible countries and international organizations. 22 U.S.C. § 2753, and Department of Defense, *Security Assistance Management Manual*, DOD 5105.38-M (Oct. 3, 2003), C4.2.

To ensure that there is an accounting of what defense articles and services are actually exported from the United States, you asked us to provide information on the scope of U.S. defense exports. Specifically, we (1) identified the magnitude and nature of defense exports and (2) assessed information currently reported on these exports and limitations and any gaps in available defense export data.

For the purpose of this report, we define “defense exports” as the permanent transfer—including shipment or delivery of defense articles or provision of defense services—to foreign entities either through DOD’s FMS program³ or through license provided by State for a DCS export. We excluded temporary exports—which leave from and return to the United States without changing ownership—and articles shipped to U.S. government end users located in foreign countries. To identify information on the magnitude and nature of defense exports, we analyzed calendar years 2005 through 2009 data from DOD for FMS defense articles and services. We also analyzed data for the same period from the Department of Commerce’s U.S. Census Bureau (Census)—which maintains data on exports—for DCS of defense articles. Currently, no data are collected on the export of defense services through DCS. Although our analysis focuses on exports of defense articles, we obtained data from State on DCS licenses primarily to assess the reliability of Census data. This report does not include values for classified defense exports. However, we determined that excluding classified data would not materially affect our high-level analysis because the values of classified exports are small relative to the overall export totals. We assessed the reliability of defense export data by performing electronic testing, reviewing system documentation, comparing our data to published and other available information, and interviewing knowledgeable officials about data quality and reliability, and determined that the data were sufficiently reliable for the purpose of this review. For trend analysis—that is, changes in values over time—we adjusted for the effects of inflation by converting values to 2009 constant dollars.

³ We did not include articles exported under DOD’s excess defense article program or articles and services exported under sections 1206 and 1207 of the National Defense Authorization Act for Fiscal Year 2006. Section 1206 authorized the President to direct the Secretary of Defense to build or support the capacity of foreign military forces to conduct counterterrorist operations or to support stability and military operations in which the United States is a participant. Section 1207 authorized the Secretary of Defense to transfer defense articles to the Secretary of State to facilitate the reconstruction, security, or stability assistance provided to a foreign country.

To compare export data through FMS and DCS, we analyzed the different item classification systems used by State, DOD, and Census and developed a common classification system enabling analysis of the values of defense articles by type of items. We also reviewed relevant laws and regulations regarding the export of defense articles and the requirements for reporting export information through Census's Automated Export System (AES). To identify information currently reported on defense exports, we obtained and analyzed the reports issued by State's Directorate of Defense Trade Controls (DDTC) and DOD's Defense Security Cooperation Agency (DSCA).⁴ To identify any limitations and gaps in the agencies' data collection and reporting, we reviewed data systems and related documentation at DDTC, DSCA, and Census. We also interviewed officials at these agencies and at the Department of Homeland Security's U.S. Customs and Border Protection (CBP) on their export data collection processes. Information on dual-use items—which can have both commercial and military uses and are regulated by the Department of Commerce under a separate control list—is outside the scope of this review. For more detailed information on our scope and methodology, see appendix I.

We conducted this performance audit from February 2010 to September 2010 in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

Background

The Arms Export Control Act⁵ authorizes the President to control the export and import of defense articles and defense services. The statutory authority of the President to promulgate regulations with respect to exports of defense articles and defense services and designate those items to be considered defense articles and defense services⁶ for export control

⁴ The information discussed in this report on the reporting requirements does not reflect our independent legal analysis or determination of the specific requirements. Rather, it is generally descriptive and reflects the differing interpretations, implementation of the requirements, or both by State and DOD.

⁵ 22 U.S.C. § 2751 et seq.

⁶ 22 U.S.C. §§ 2778(a) and 2794(7).

purposes has been delegated to the Secretary of State.⁷ State administers the arms export control system through requirements contained in the International Traffic in Arms Regulations (ITAR)⁸ and designates the articles and services deemed to be defense articles and defense services. These designations are made by State, with the concurrence of DOD, and constitute the United States Munitions List⁹ (USML), which comprises 21 major categories—for example Aircraft, Spacecraft, Military Electronics, and Guns and Armament—and more detailed subcategories. The ITAR also designates defense services subject to export controls, including furnishing assistance, technical data, or training to foreign entities. As defense exports are part of U.S. foreign policy, Congress requires reports to enable its oversight, including annual reports under the Foreign Assistance Act of 1961, as amended,¹⁰ Section 655 on defense exports, commonly referred to as Section 655 reports.

U.S. defense articles and services generally can be exported to foreign entities in two ways—by FMS or DCS. Under FMS, the U.S. government procures defense articles and services on behalf of the foreign entity. Countries approved to participate in this program may obtain defense articles and services by paying with their own funds or with funds provided through U.S. government-sponsored assistance programs. While State has overall regulatory responsibility for the FMS program and approves the export of defense articles and services, DOD’s DSCA directs the execution of the program, and the individual military departments implement the sale and export process. DOD bills foreign entities and tracks the export of articles and services through its financial systems. For FMS, an approved Letter of Offer and Acceptance authorizes the export. Under DCS, U.S. companies obtain permanent export licenses generally valid for 4 years¹¹ from State’s DDTC, which authorizes the export of defense articles and services directly to foreign entities. State also licenses defense articles for temporary export—when the article will be exported for a period of less than 4 years and will be returned to the United States without transfer of title.

⁷ Exec. Order No. 11,958, 42 Fed. Reg. 4,311 (1997).

⁸ 22 C.F.R. § 120 et seq.

⁹ 22 C.F.R. § 120.2; 22 C.F.R. Part 121.

¹⁰ 22 U.S.C. § 2415.

¹¹ For the export of defense services, State authorizes technical assistance agreements, which State officials said are generally valid for 10 years.

While most defense articles and services require a license for export, the ITAR contains numerous exemptions from licensing requirements that have defined conditions and limitations. For both FMS and DCS, the actual export of defense articles or services may occur years after the authorization—or may not take place at all.

In addition to State and DOD, other U.S. government entities are involved with oversight of defense exports and management of export data. CBP oversees exports of defense articles leaving the country for compliance with export control laws and regulations and collects information on those exports through AES. AES is jointly managed and operated by CBP and Census, and the data it collects are used by State and other federal agencies. It is the central point through which export data required by multiple agencies are filed electronically to CBP. Foreign Trade Regulations¹² and the ITAR require AES filings for all articles on the USML that are sent, taken, or transported out of the United States, and the exporter must provide either a license number or a citation of the license exemption. The data obtained through AES are maintained by Census's Foreign Trade Division and CBP for the purpose of developing merchandise trade statistics and enforcement of U.S. export control laws, but also are provided to State for reporting purposes.

DCSA information on the FMS program identifies several considerations for foreign entities in choosing between FMS and DCS. Under FMS, DOD procures defense articles and services for the foreign entity under the same acquisition process used for its own military needs, and recipients may benefit from economies of scale achieved through combining FMS purchases with DOD's. In addition, DOD provides contract administration services that may not be available through the private sector. To recover its administration costs, DOD applies a surcharge to each FMS agreement that is a percentage of the value of each sale. Under DCS, foreign entities may have more direct involvement during contract negotiation with U.S. defense companies, may obtain firm-fixed pricing, and may be better able to fulfill nonstandard requirements. However, according to State officials, some types of defense articles, such as certain types of missiles, can only be exported through FMS.

In addition, DOD administers other programs through which defense articles can be exported to foreign governments. For example, the fiscal

¹² 15 C.F.R. § 30.2.

year 2006 National Defense Authorization Act¹³ provides funding authorities for DOD to jointly formulate and coordinate with State in the implementation of security assistance programs, which can include the export of U.S. defense articles and services. DOD also may export certain defense articles deemed “excess” to our national security needs to foreign governments or international organizations on a reduced or no-cost basis.

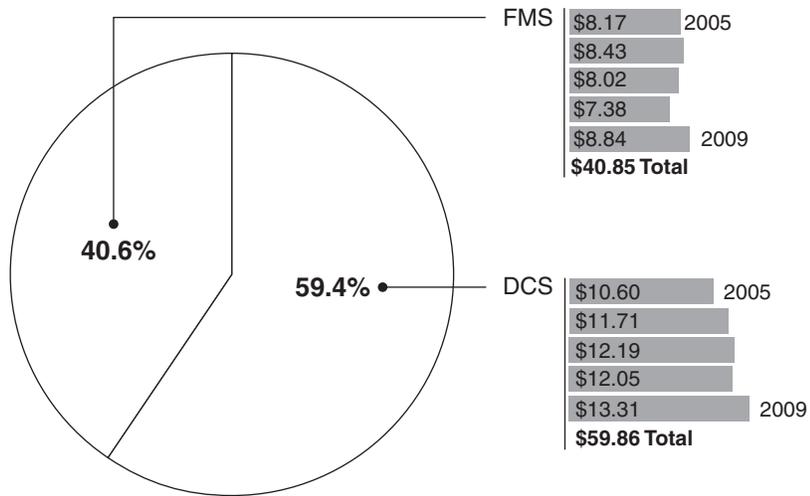
The Majority of U.S. Defense Articles Are Exported through Direct Commercial Sales, with About Half Going to Relatively Few Countries

From calendar years 2005 through 2008, the value of U.S. exports of defense articles remained relatively stable, from about \$19 billion and \$20 billion,¹⁴ with an increase to about \$22 billion in 2009. Of the approximately \$101 billion total in U.S. defense articles exported from 2005 through 2009, about 60 percent were exported through DCS, as shown in figure 1. This figure also shows that exports through DCS increased from \$10.6 billion to \$13.3 billion during this period—an increase of about 25 percent—while the value of FMS exports remained relatively stable.

¹³ National Defense Authorization Act for Fiscal Year 2006, Pub. L. No. 109-163 §§ 1206 and 1207 (2006).

¹⁴ In 2009 constant dollars.

Figure 1: Exports of Defense Articles through DCS and FMS, Calendar Years 2005 through 2009



Source: GAO analysis of DOD and Census data.

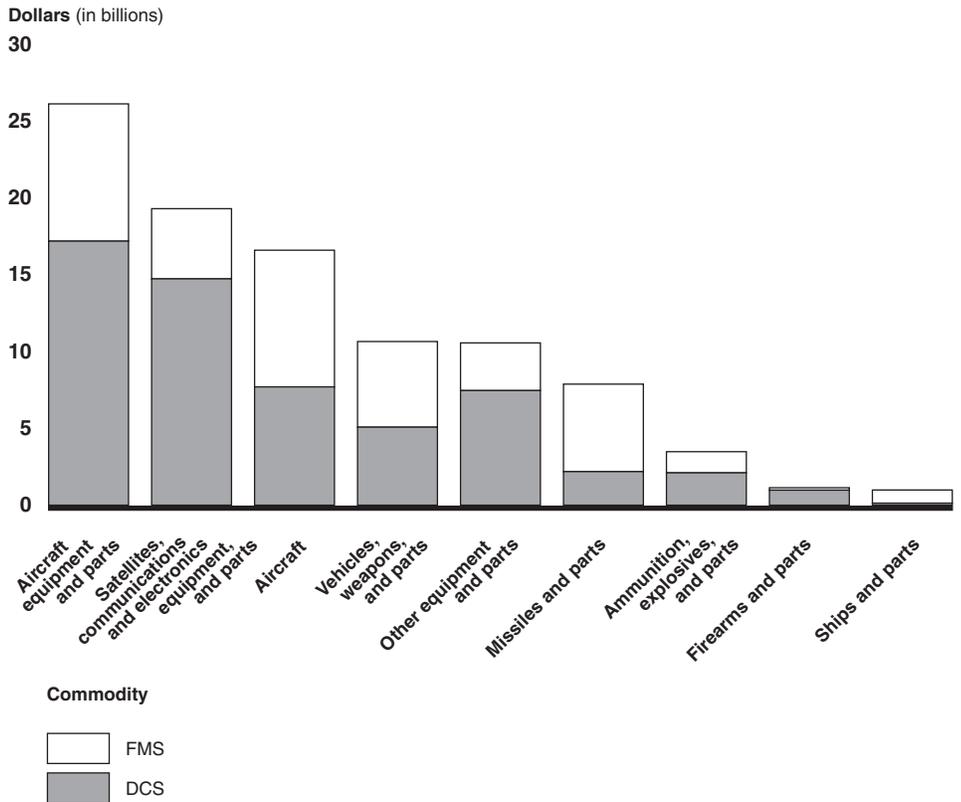
Note: All values are in billions and are adjusted to 2009 constant dollars. Values may not add to totals because of rounding.

Although there are currently no data available on the export of defense services through DCS, we found that the value of defense services exported through FMS was also relatively stable over the last 5 calendar years, ranging from about \$3.8 billion to \$4.2 billion annually from 2005 through 2009. Overall, services account for about one-third of the value of all FMS exports annually.

Over the last 5 years, aircraft and their related parts and equipment accounted for about 44 percent of the value of all defense articles exported. The second largest category was satellites, communications, and electronics equipment and their related parts—accounting for about 20 percent of defense articles. We also found differences in the method of export for defense articles, with values for some types of articles higher through FMS versus DCS and vice versa. As shown in figure 2, of the approximately \$26 billion in aircraft equipment and parts exported over the 5-year period, almost 66 percent (about \$17.2 billion) was exported through DCS. A much larger value of other equipment and parts; satellites, communications and electronics equipment, and related parts; and firearms were also exported through DCS. On the other hand, a larger value of missiles, ships, and their related parts were exported through

FMS. For two categories—aircraft and vehicles, weapons, and their parts—export values were about evenly divided between DCS and FMS.

Figure 2: Value of Exports through FMS and DCS from Calendar Years 2005 through 2009 by Type of Defense Articles



Source: GAO analysis of DOD and Census data.

Note: Values are not adjusted for inflation.

Although defense articles and services are exported to hundreds of countries, we found that exports of defense articles were highly concentrated in a few countries. Over the past 5 years, the top three recipient countries—Japan, the United Kingdom, and Israel—accounted for almost one-third of the value of defense article exports. The top seven recipient countries, which include South Korea, Australia, Egypt, and the United Arab Emirates, accounted for about half of the value of all U.S.

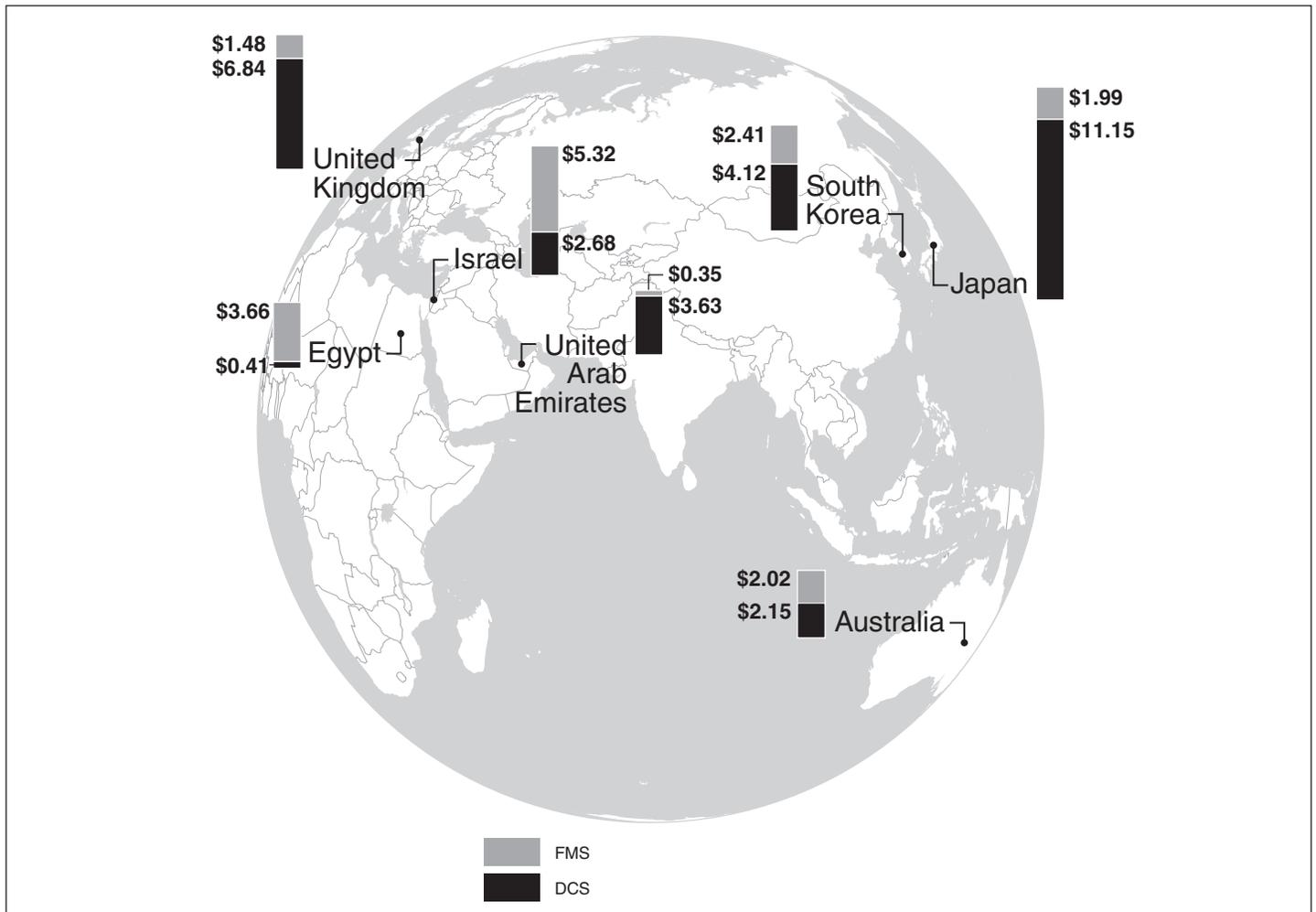
defense article exports.¹⁵ We also identified differences by the method of export through either FMS or DCS. In general, the value of FMS exports was higher for developing countries, while the value of DCS exports was higher for developed¹⁶ countries. State officials noted that developing countries may benefit from the FMS logistics, infrastructure, and other support that come with the FMS program. As shown in figure 3, of the \$13 billion in defense articles that Japan imported, 85 percent (\$11.15 billion) was exported through DCS. Similarly, of the \$8.3 billion that the United Kingdom imported, 82 percent (about \$6.8 billion) was exported through DCS. On the other hand, Israel and Egypt import a higher value of their U.S. defense articles through the FMS program. Israel and Egypt receive annual U.S. security assistance funding¹⁷ that according to DOD and State officials, generally is used to purchase U.S. defense articles and services through the FMS program. FMS exports of defense services were also concentrated in a relatively few countries, with Saudi Arabia, Japan, and Egypt accounting for over one-third of the value over the last 5 years.

¹⁵ Canada was the eighth largest recipient of U.S. defense articles at \$3.6 billion exported under FMS and DCS. However, another \$4.1 billion of defense articles was exported to Canada under a license exemption, which can include both temporary and permanent exports that are not separately delineated in the AES data. Therefore, the value of Canada's permanent defense imports from the United States is likely understated.

¹⁶ As defined by the United Nations, Japan in Asia, Canada and the United States in northern America, Australia and New Zealand in Oceania, and Europe are considered "developed" regions or areas. All other regions are considered "developing."

¹⁷ For example, in fiscal year 2008, Israel and Egypt received about \$2.4 billion and \$1.3 billion, respectively, in Foreign Military Financing funds to improve their military capabilities.

Figure 3: Top Seven Countries for Exports of Defense Articles, Calendar Years 2005 through 2009



Source: GAO analysis of DOD and Census data.

Note: Values are in billions of dollars and are not adjusted for inflation.

Differences in Agencies' Reporting and Data Collection Limit Visibility of Defense Exports

Although Congress requires reporting on various aspects of U.S. defense exports, State's and DOD's annual reports on "military assistance and military exports"—as required by Section 655 of the Foreign Assistance Act of 1961, as amended—do not provide a complete picture of the magnitude and nature of defense exports because the agencies use different reporting methodologies and have information inconsistencies and gaps—in part, because of the separate purposes of their data systems. Although the data we obtained and analyzed were sufficiently reliable to

develop high-level, overall information on the magnitude and nature of defense exports, the differences in agencies' data—including the lack of information for defense services exported under DCS licenses, differences in agencies' item and country categorizations, and the inability to separate some permanent and temporary exports—hinder the ability to provide a comprehensive and transparent picture of defense exports. Current export reform discussions acknowledge that the proliferation of individual data systems make export licensing and enforcement more difficult; however, the FMS system has not been specifically cited in these proposals.

Because defense exports are used for furthering U.S. foreign policy objectives, there are legislatively mandated reporting requirements to enable congressional oversight. State has overall responsibility to report on exports of defense articles and defense services. DOD also reports on defense exports under FMS and other programs. The most comprehensive reporting requirement is contained in Section 655 of the Foreign Assistance Act of 1961, as amended, which requires annual reporting of defense articles and services that were authorized and provided (exported)¹⁸ to each foreign country and international organization for the previous fiscal year under State export license or furnished under FMS, including those furnished with the financial assistance of the U.S. government.¹⁹ Also, for defense articles licensed for export by State, the act requires “a specification of those defense articles that were exported during the fiscal year covered by the report.” There is not a parallel provision for a specification of defense services exported under licenses issued by State. In addition, the act requires that unclassified portions of the report be made public on the Internet through State. Although State publishes its Section 655 reports on its Web site, DOD's Section 655 reports are not available either through DOD's or State's Web site. Other reporting requirements are focused on discrete aspects of defense exports and, as such, are not intended to provide a complete picture of such exports. For example, Section 36 of the Arms Export Control Act requires advance notifications to Congress for proposed sales based on certain dollar thresholds, as well as reports on defense exports sold. DOD also noted numerous additional reporting requirements for defense exports that occur under other programs, such as Excess Defense Articles and International Military Education and Training.

¹⁸ Because authorizations are valid for several years, exports during a fiscal year may be based on authorizations from prior years.

¹⁹ 22 U.S.C. § 2415.

While State and DOD each provide annual reports to Congress in response to the Section 655 requirement, we identified differences in the way each agency reports its data—in some cases based on differing interpretations of the same requirement—that lead to an incomplete overall picture of the magnitude and nature of such exports, as shown in table 1.

Table 1: Differences in Agencies’ Reporting on Defense Exports

State’s Section 655 report	DOD’s Section 655 report
<p><i>Authorized during the fiscal year</i></p> <ul style="list-style-type: none"> Includes values for approved licenses for permanent exports of defense articles listed by country and USML category and subcategory. <ul style="list-style-type: none"> These values include licenses to U.S. government end users located in foreign countries. Includes values for approved licenses for export of defense services by country and USML category. 	<p><i>Authorized during the fiscal year</i></p> <ul style="list-style-type: none"> Does not include values for approved authorizations. <ul style="list-style-type: none"> DOD officials told us that they interpret the requirement to mean those articles exported in the fiscal year because exports must be authorized prior to export. They noted that authorizations meeting certain criteria are reported separately to Congress under other reporting requirements.
<p><i>Exported^d during the fiscal year</i></p> <ul style="list-style-type: none"> Began including export values from AES with the fiscal year 2008 report, with no export values provided in prior reports. Export values include permanent exports, temporary imports and exports, exports exempt from license requirements, and shipments to U.S. government end users in foreign countries. Values are listed as a total by country but do not provide a specification of articles exported. Values for defense services exported are not included because this information is not collected. 	<p><i>Exported^d during the fiscal year</i></p> <ul style="list-style-type: none"> Includes values for exports of defense articles and services by country and category of items. However, some reported exports are not designated as defense articles and services under the USML (e.g., fuel, generators, forklifts, and construction). Does not include values for export of defense articles and services funded by the U.S. government through non-FMS programs^b
<p><i>Availability on the Internet</i></p> <ul style="list-style-type: none"> Report is available through State’s Web site. 	<p><i>Availability on the Internet</i></p> <ul style="list-style-type: none"> Report is not made available on the Internet through DOD’s or State’s Web sites.

Source: GAO analysis of State’s and DOD’s Section 655 reports.

^aWe use the term “exported” here, while the act uses both “provided” and “exported.”

^bDSCA officials stated that prior to 2009, they were not receiving data on exports authorized by Sections 1206 and 1207 of the National Defense Authorization Act, but they are now receiving data on these exports.

The differences in reporting also occur because the data on defense exports are gathered and maintained by multiple government agencies for a variety of purposes using different data systems. State and DOD officials told us that information reported on defense exports is based on data that are contained in existing systems developed to satisfy the operational requirements of each organization and was not designed to integrate with other agencies’ systems. For example, State’s system was designed to manage the DCS licensing process, DSCA’s system was developed to facilitate the management of the FMS program, and data collected in the AES system are maintained by Census primarily for generating trade

statistics. Nonetheless, these systems are the principal sources of information on defense exports. In areas where these systems differ from each other, certain data fields need to be reconciled before data can be aggregated. Even with these adjustments, these and other system differences hinder the ability to perform a more detailed and in-depth analysis of defense exports.

For example, one difference between State's and DOD's reporting is the lack of data on defense services exported under DCS licenses. According to State's reporting to Congress, for fiscal year 2005, it licensed²⁰ over \$27 billion in defense services. By fiscal year 2008, the most recent data available, the value of approved licenses for defense services almost tripled to over \$71 billion. However, State does not report on the value of defense services exported under license authorizations because it does not have such information. This is in part because AES does not capture data on the export of services to foreign entities as it was developed to track information on the export of physical articles. Also, State officials noted that they have no operational requirement to have information on the value of exported defense services, and they do not require such information to be reported to State as it could create an additional burden on exporters. Further, these officials noted that they have not received feedback from congressional committees on the lack of such data in prior reports to Congress and therefore are not planning to obtain these data from exporters. In contrast, because DOD bills FMS customers for the export of defense services—including logistical support, repairs, training, and technical assistance—it tracks data on the value of services exported. As noted earlier in this report, defense services constitute about one-third of annual FMS exports.

Further complicating efforts to combine and compare State and DOD data reported in the Section 655 reports is that agencies involved in the licensing, export, and collection of related data lack a unified item categorization scheme. According to agency officials, these item categorization schemes were developed for their specific purposes and were not designed to integrate with other agencies' data for reporting defense exports. In issuing DCS licenses, State uses the categories for defense articles and services enumerated on the USML and reports license values by USML categories and subcategories. However, when exporters

²⁰ Services may be exported over the 10-year period covered by the license, and the value of services exported may be less than the authorized amounts.

file their export information through AES for these licensed exports, they include the USML category that provides a high-level categorization of articles (e.g., “Aircraft and Associated Equipment”) but does not allow for the more detailed breakout of articles by subcategories, which State uses to report license values. Exporters also categorize articles according to the Harmonized Tariff Schedule, based on the international “Harmonized System,” which was developed for reporting merchandise trade statistics. The Harmonized System and USML are not directly comparable. For example, while the USML has a category for “tanks and military vehicles” separate from other categories for weapons, the Harmonized System has one combined category that includes both weapons and “weaponized” vehicles such as tanks and armored vehicles. As a result, a more detailed combined analysis of the types of military vehicles is not possible using existing category schemes.

Under the FMS program, DOD reports export values based on information used to bill foreign entities using a unique item categorization system that also is not directly comparable to the USML. For example, the USML has separate categories for explosives, bombs, training equipment, and guidance equipment; DOD’s single category for “bomb” includes items in all of those USML categories. Further, some of the articles and services exported through the FMS program, such as fuel and construction, are not controlled under the USML. However, since DOD bills foreign entities for these articles and services, they are included in DOD’s reports along with defense articles and services. DOD officials noted that there is no requirement to report exports by USML categories.

Defense export data comparisons also are limited because DOD, Census, and State define some countries and international organizations differently. For example, DOD’s FMS data and State export license authorizations include exports to international organizations such as the United Nations. Exports documented through AES are coded for the country of destination and not for international organizations that may be located within those countries. Furthermore, each agency’s system uses different codes for some countries, requiring manual analysis to enable combining and comparing of these data. For example, the code used for a country in one database may be used for a different country in another database, and some country names are different. These differences hamper efforts to make comparisons between the systems or to combine the databases to analyze like exports to countries and international organizations.

Another difference between State's and DOD's Section 655 reports is State's inclusion of U.S. government end users in its data. While all exports under FMS are to foreign entities, State reports license authorization values for exports that are used by U.S. government agencies within the recipient country as well as articles exported for use by U.S. and allied forces operating on foreign soil. Because the values reported for exports of defense articles include these U.S. government end users, the value of such articles exported to foreign entities is overstated.

In addition, obtaining precise data on DCS exports is further limited for certain types of exports where permanent and temporary exports are grouped together. For example, both temporary and permanent exports of classified items are identified under a single export license type. For 2005 through 2009, this license type included a total of about \$7 billion in exports, which can include temporary exports. In addition, the ITAR provides for a license exemption for some defense articles exported to Canada.²¹ However, the ITAR provides a single Canadian exemption that includes both permanent and temporary exports. As noted earlier, defense export data for Canada are likely understated since the data do not delineate permanent exports from temporary ones in the approximately \$4.1 billion reported under this exemption from 2005 through 2009.

DOD's reporting of total defense exports is also limited by the lack of data on exports of defense articles and services under certain U.S. government-funded programs. For example, until recently DSCA did not have access to centralized data on defense exports authorized under sections 1206 and 1207 of the National Defense Authorization Act for Fiscal Year 2006. Such exports are tracked separately from FMS cases—generally by the appropriation that funded the export. In 2009, the DSCA system identified a cumulative total for these exports that included multiple years with no way to separate the data by the year of export. However, DSCA officials told us that they now receive monthly updates on these exports and are considering options for including these data in future reporting. Furthermore, officials at Census, CBP, and DOD told us that reporting through AES for FMS exports is not complete, although the U.S. Foreign Trade Regulations and the ITAR require AES filings for all USML items exported from the United States including those exported through FMS.²² DOD officials noted that while AES filing is required, not all DOD

²¹ 22 C.F.R. 126.5.

²² 30 C.F.R. § 30.2; 22 C.F.R. § 123.22.

components fully comply. Census officials stated that they are providing outreach and training for DOD components to encourage compliance with this requirement. CBP officials noted that reporting of FMS exports through AES has improved over the years, and our analysis of AES data showed that the value of FMS exports reported in AES has increased from 2005 to 2009.

Under the U.S. export control reform effort currently under way, the administration has noted that the myriad of U.S. government agencies involved in export controls continue to maintain separate information technology systems and databases that are not accessible or easily compatible with each other. According to a recent statement by the U.S. National Security Advisor,²³ this proliferation of individual systems makes export licensing and enforcement more difficult. In our *High-Risk Series*, we found weaknesses in the effectiveness and efficiency of U.S. government programs that are related to the protection of technologies critical to national security interests, such as FMS and DCS, and recommended that these programs be reexamined to determine how they can collectively achieve their missions.²⁴ The U.S. government is currently considering consolidating the current export control lists and adopting a single multiagency system for licensing with a single interface for exporters, ultimately leading to a single enterprisewide information technology system that can track an export from the filing of a license application until the item leaves a U.S. port. However, the administration has not announced plans on how defense articles and services authorized and exported under FMS and other government-to-government programs will be incorporated into a reformed U.S. export control system.

Conclusions

A complete picture of defense exports—including which method of export is used more often by individual countries or for certain types of items—is not available under current reporting to Congress. Although State has overall responsibility to regulate the export of defense articles and services, it reports separately from DOD on some aspects of defense exports. Information from DOD and State cannot be readily combined to provide a complete picture of defense exports. Gaps and limitations in

²³ “The Administration’s Export Control Reform Plans,” remarks by General James L. Jones, USMC (Ret), National Security Advisor, at the Senate Aerospace Caucus luncheon, June 30, 2010.

²⁴ [GAO-07-310](#).

these data—including the lack of information on defense services exported under DCS, which could be substantial given the high dollar value of such services authorized by State—may inhibit congressional oversight and transparency into the entirety of U.S. defense exports. For example, Congress does not have complete data to determine whether specific U.S. foreign policy objectives are being furthered through the various export programs. While State has noted a potential burden for exporters if they were required to report on exports of defense services under DCS, there may be value to Congress in having such information, especially in light of the large and growing value of license authorizations for defense services.

As U.S. export control reform efforts move beyond the initial phase of revising and consolidating control lists, it will be important to consider ways to standardize and integrate data across agencies to mitigate the gaps and limitations noted in this report. Recognizing that complete integration and standardization across agencies' data systems is a long-term effort that may require additional resources, State could improve overall reporting of defense exports under the constraints of current data systems by using a methodology similar to ours to enhance congressional oversight and transparency of such exports. Also, as policymakers develop and debate export control reform proposals, it is important to consider whether other programs related to the protection of technologies critical to U.S. national security, such as the FMS program, should be included in the reform efforts.

Matter for Congressional Consideration

In order to obtain a more complete picture of defense exports, Congress should consider whether it needs specific data on exported defense services similar to what it currently receives on defense articles and, if so, request that State provide such data as appropriate.

Recommendation for Executive Action

To improve transparency and consistency of reporting on defense exports required by the Foreign Assistance Act, we recommend that the Secretary of State direct the Directorate of Defense Trade Controls to coordinate with the Departments of Defense and Commerce to identify and obtain relevant defense export information under existing agency data systems and provide a consolidated report to Congress on DCS and FMS that

- specifies articles exported using a common category system;
- separates U.S. government end users from foreign entities;
- separates permanent and temporary exports;

-
- incorporates all defense exports, including U.S. government-funded programs; and
 - is made public through the Internet.

Agency Comments and Our Evaluation

We provided a draft of this report to the Departments of State, Homeland Security, and Defense and to Census under the Department of Commerce for their review and comment. Census and the Department of Homeland Security provided technical comments, which we incorporated as appropriate, and DOD did not comment on our draft. State provided written comments that are reprinted in appendix II. In commenting on the draft, State acknowledged the importance of maintaining and reporting to Congress and the public reliable data on U.S. defense exports through FMS and DCS, and notes that gaps and inconsistencies in current reporting are caused by differences in accounting by agencies for transfers of defense exports. However, State did not agree with our recommendation to report consolidated defense export data on FMS and DCS in a consistent manner. State reiterated that Congress has not requested any change to the substance of its current reporting, and State does not believe that the added resources necessary to change reporting formats are merited. However, based on our work and analysis of defense export data, we believe that congressional oversight and transparency into the entirety of U.S. defense exports could be improved with existing data and systems by utilizing more consistent reporting methodologies similar to those that we developed. State also noted that providing consolidated defense export data to Congress and the public was consistent with the goals of current export control reform efforts and encouraged Congress to provide criteria and the resources to develop appropriate information. We agree that ongoing export control reform efforts may provide opportunities to improve information and reporting, but recognizing that reforms may take years to implement, we believe that congressional oversight and transparency can be improved in the short term by implementing our recommendation.

We are sending copies of this report to interested congressional committees, the Secretary of State, the Secretary of Defense, the Secretary of Commerce, and the Secretary of Homeland Security. This report also is available at no charge on the GAO Web site at <http://www.gao.gov>.

If you have questions about this report or need additional information, please contact me at (202) 512-4841 or martinb@gao.gov. Contact points for our Offices of Congressional Relations and Public Affairs may be found

on the last page of this report. Key contributors to this report are listed in appendix III.

A handwritten signature in black ink that reads "Belva M. Martin". The signature is written in a cursive style with a large initial 'B' and 'M'.

Belva M. Martin
Acting Director
Acquisition and Sourcing Management

Appendix I: Scope and Methodology

To identify information on the magnitude and nature of defense exports, we obtained data for calendar years 2005 through 2009 on direct commercial sales (DCS) from the U.S. Census Bureau's (Census) Automated Export System (AES) and on the Foreign Military Sales (FMS) program from the Department of Defense's (DOD) Defense Security Cooperation Agency (DSCA). For the purpose of this report, we defined "defense exports" as articles permanently exported under a Department of State (State) license to foreign end users. As such, we did not include temporary exports that return to the United States without transfer of ownership, shipments to U.S. government end users as identified in AES by the export information code, or articles exported under a license exemption.

- For DCS, we obtained a data extract from Census for AES records for this time frame of electronic information filings designated with a State "license type," a required field for all exports covered by the United States Munitions List (USML). State has several different license types that generally identify the nature of the export or import, including permanent exports, temporary exports, temporary imports, agreements, articles exported with an exemption, or articles exported through the FMS program. For FMS data, although Foreign Trade Regulations and the International Traffic in Arms Regulations require AES filings for all articles on the USML, including those exported via FMS, we were told by both U.S. Customs and Border Protection (CBP) and Census officials that AES filings for DOD exports of FMS articles are not complete. Therefore, we could not use AES as a single data source for exports of defense articles.
- For this reason, we obtained data from DSCA for FMS exports for the same time frame from DSCA's 1200 Delivery Subsystem. We did not include articles exported under Section 1206 or 1207 programs under the National Defense Authorization Act for Fiscal Year 2006. As noted, DSCA did not obtain export data on Section 1206 and 1207 exports until 2009. We also did not include data on DOD's excess defense article program.
- Although most of our analysis focuses on exports of defense articles, we obtained data from State on DCS licenses that were in effect during 2005 through 2009, primarily for the purpose of assessing the reliability of AES data for these exports.
- For each of these three data sets, we also obtained the relevant reference tables and documentation from each agency. These reference tables translate the codes used in the databases—such as those for country name or commodity/item type—into their names or descriptions.

- We also reviewed relevant laws and regulations regarding the export of defense articles and requirements for reporting export information through AES.¹

In order to combine and compare information from FMS and AES on the types of articles exported, we analyzed the item categorization systems used by each system to identify areas of commonality. We determined that the broad categories used by DOD for grouping like items together could be adapted to accommodate the lowest level of detail identified between the two systems. This allowed us to develop relatively large categories, but precluded us from further refining the analysis by breaking these out into more detailed categories because some types of items were combined into one category in either of the two systems.

To assess overall defense exports by country, we created a cross-reference table to enable us to relate the data for a specific country in one data set to information for that same country in the other data set. We also identified groupings of countries considered developed or developing according to the United Nations' definition.

We did not include data on classified exports for either FMS or DCS. DOD officials stated that classified data on FMS exports could not be used in an unclassified report, even if aggregated with other data. We obtained and reviewed classified data for FMS and determined that excluding the FMS classified data from our analysis would not materially affect the high-level trend analysis and other information we discuss in this report. For classified DCS exports, temporary and permanent exports are grouped together in one license type in AES, with no way to separate permanent from temporary exports.

For trend information across the 5-year time frame, we adjusted for the effects of inflation by converting values to 2009 dollars. We assessed the reliability of these data by performing electronic testing; reviewing system documentation, including system edits and validations; comparing our data to published or other available information; and interviewing knowledgeable officials about data quality and reliability. For the purposes of our analyses, we determined that the data were sufficiently reliable.

¹ As previously indicated, the information discussed in this report on the reporting requirements does not reflect our independent legal analysis or determination of the specific requirements. Rather, it is generally descriptive and reflects the differing interpretations, implementation of the requirements, or both by State and DOD.

To assess information reported on U.S. defense exports, we reviewed relevant reporting requirements and reviewed State and DOD reports to Congress on various portions of the export process, including notification of potential sales, authorizations, and exports. Specifically, we reviewed the reporting requirements in the Foreign Assistance Act of 1961, as amended, Section 655, on foreign military assistance that requires an annual report on both defense articles and services authorized and provided/exported to foreign countries and international organizations. We then analyzed and compared the relevant reports that State and DOD annually submit to Congress, identifying differences in reporting methodologies between the reports, and identified where such information is available to the public. We also interviewed agency officials at State's Directorate of Defense Trade Controls (DDTC) and DOD's DSCA responsible for generating these reports to obtain information on methodologies and definitions used in their respective reports. To identify limitations and gaps in available defense export data, we reviewed information and available system documentation for the data systems at DSCA, DDTC, and Census and interviewed knowledgeable officials at these agencies regarding data system purposes and functionality. We also interviewed officials at CBP who manage the AES interface with exporters.

We conducted this performance audit from February 2010 to September 2010 in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

Appendix II: Comments from the Department of State



United States Department of State

Chief Financial Officer

Washington, D.C. 20520

SEP 14 2010

Ms. Jacquelyn Williams-Bridgers
Managing Director
International Affairs and Trade
Government Accountability Office
441 G Street, N.W.
Washington, D.C. 20548-0001

Dear Ms. Williams-Bridgers:

We appreciate the opportunity to review your draft report, "DEFENSE EXPORTS: Reporting on Exported Articles and Services to Be Improved," GAO Job Code 120862.

The enclosed Department of State comments are provided for incorporation with this letter as an appendix to the final report.

If you have any questions concerning this response, please contact Steven Rice, Deputy Director, Bureau of Political-Military Affairs at (202) 663-2803.

Sincerely,

A handwritten signature in black ink, appearing to read "BARBARA RETZLAFF", written over a white background.

Barbara Retzlaff

cc: GAO – John Neumann
PM – Andrew J. Shapiro
State/OIG – Evelyn Klemstine

Department of State Comments on GAO Draft Report

DEFENSE EXPORTS:
Reporting on Exported Articles and Services Needs to Be Improved
(GAO-10-952, GAO Code 120862)

Thank you for the opportunity to comment on your draft report entitled “DEFENSE EXPORTS: Reporting on Exported Articles and Services Needs to Be Improved.” The Department of State recognizes the importance of maintaining and reporting to the Congress and public reliable data on United States defense exports through direct commercial sales or the Foreign Military Sales program. The draft report identifies gaps and inconsistencies in reports of this nature by the Executive Branch.

However, the State Department notes that gaps and inconsistencies in reporting are inherent in accounting for transfers of defense export across agencies. While Foreign Military sales may, for example, include items such as tanks and weaponry on the U.S. Munitions List under the jurisdiction of the Department of State, dual-use items under the licensing jurisdiction of Commerce will not be included in State reports. Likewise, the requirements of the Congress for reporting direct commercial sales and Foreign Military Sales are also different.

The Department of State faithfully reports to Congress all data pertaining to exported articles and services that are within its jurisdiction to collect. To date, the Congress has expressed no desire to change the substance of our current reporting. The Department does not believe that devising additional reporting formats would merit the commitment or allocation of additional resources and therefore disagrees with the report's recommendations.

Providing consolidated defense export data to Congress and the public is consistent with the goals of Export Control Reform and the Executive Branch task force evaluating proposals and recommendations associated with it. As decisions are made on Export Control Reform, the Department of State encourages the Congress to furnish criteria and resources to develop appropriate information technology platforms and reporting criteria of benefit to both the Congress and the public.

Appendix III: GAO Contact and Staff Acknowledgments

GAO Contact

Belva M. Martin, (202) 512-4841 or martinb@gao.gov

Staff Acknowledgments

In addition to the contact named above, John Neumann, Assistant Director; Marie Ahearn; Richard Brown; Sharron Candon; Julia Kennon; Roxanna Sun; Robert Swierczek; and Bradley Terry made key contributions to this report.

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