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SUMMARY STATEMENT OF REPORT TO THE CONGRESS



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The Government's Role In East-West Trade- Problems And Issues

Multiagency

Renewed commercial relations between the United States and Communist countries have raised public and congressional interest in the benefits of such trade, the policies being followed, and the executive branch's role in bilateral and multilateral East-West trade issues.

GAO's report reviews East-West trade policies, programs, and procedures to provide information on, and an assessment of, the executive branch's role.

**BY THE COMPTROLLER GENERAL
OF THE UNITED STATES**

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COMPTROLLER GENERAL OF THE UNITED STATES
WASHINGTON, D.C. 20548

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To the President of the Senate and the
Speaker of the House of Representatives

This is the summary statement of our classified report on the Government's role in East-West Trade-- problems and issues. It is being issued concurrently with the report.

We are sending copies of this statement to the Director, Office of Management and Budget; Executive Director, Council on International Economic Policy; Assistants to the President for National Security and Economic Affairs; Special Representative for Trade Negotiations; Director, Central Intelligence Agency; Chairman, Export-Import Bank of the United States; and the Secretaries of Agriculture, Commerce, Defense, State, and the Treasury.

A handwritten signature in cursive script, reading "Thomas B. Stearns".

Comptroller General
of the United States

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APPENDIX

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- I Letter dated October 21, 1975, from
Executive Secretary, East-West Foreign
Trade Board

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GAO Note: Comments in Appendix I were provided in response to our overall classified report. This summary statement does not contain the detailed information on which our conclusions and recommendations are based. Agency comments and our evaluations are included at the end of appropriate chapters. The response is cross-referenced to applicable sections of this statement.

- II Principal officials responsible for administration of activities discussed in this statement

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ABBREVIATIONS

ACEP	Advisory Committee on Export Policy
CCC	Commodity Credit Corporation
CIEP	Council on International Economic Policy
COCOM	International Export Control Coordinating Committee
EDAC	Economic Defense Advisory Committee
EPB	Economic Policy Board
GAO	General Accounting Office
NAC	National Advisory Council on International Monetary and Financial Policies
NSC	National Security Council
OEA	Office of Export Administration
OECD	Organization for Economic Cooperation and Development

SUMMARY STATEMENT OF
COMPTROLLER GENERAL'S
REPORT TO THE CONGRESS

THE GOVERNMENT'S ROLE IN
EAST-WEST TRADE--
PROBLEMS AND ISSUES
Multiagency

D I G E S T

Stimulation of trade is a fundamental part of the United States endeavor to improve relations with Communist countries. The nature of the relationship necessitates coordinated negotiations across a spectrum of political, strategic, and economic issues. U.S. policy is based on the assumption that such countries are willing to develop and maintain constructive and harmonious relationships for economic gains.

U.S. trade with Communist countries resulted in a \$1.2 billion surplus in 1974 and will produce a larger surplus in 1975. This trade represented 2 percent of U.S. exports and 3 percent of U.S. imports. The major importance of this trade is political, since its overall economic importance on the national economy is limited. U.S. trade with its major trading partners far outweighs the potential economic benefits from expanded trade with Communist countries.

General assessment

Trade with Communist countries involves different economic concepts and political ideologies which require special governmental institutions and arrangements not found in trade with the Western world. The concentrated economic leverage and global intelligence that a centrally planned economy can bring into the trade relationship places U.S. firms at a disadvantage in negotiations. The limited degree of executive branch involvement and unilateral actions by American firms do not provide adequate protection of U.S. national interests in matters such as the transfer of advanced technologies through informal exchanges and discussions.

In assessing the effectiveness of the U.S. response to the issues involved in East-West trade, GAO found that the U.S. Government needs

to establish rules and procedures which both protect and promote U.S. interests. The U.S. response has been complicated by difficulties in four major areas: policy formation, promotion and financing programs, export controls and technology exchanges, and capacity to achieve a balance of diplomatic and commercial benefits.

1. U.S. trade policy basically has been developed through a political and strategic interagency decisionmaking process. This process has not insured that U.S. positions were clearly defined and properly analyzed before decisions or implementation plans were made. The principal reasons are:

--Differing perceptions of executive agencies, each with certain interests and influence, on the direction and objectives for improving relations with Communist countries. The ultimate direction of policy is frequently shaped by the agency given the lead for determining policy options.

--Absence of procedures for congressional involvement in executive branch foreign trade negotiations. (See pp. 2 to 9 and 52 to 59.)

2. To support its foreign policy initiatives, as well as to enhance the purely commercial benefits of trade, the executive branch established Government and private sector institutions to promote, facilitate, and monitor trade with Communist countries.

Promotional activities which support U.S. firms in trading with Communist countries have succeeded in establishing trade relationships, but some activities, such as executive-level and industry-organized Government-approved trade missions, are of questionable effectiveness. (See pp. 12 and 13.)

The Export-Import Bank of the United States finances the export sales of U.S. goods and services. Before restrictions were placed on its activity by the Eximbank and Trade Acts of 1974, Eximbank had extended direct loan credits to Romania, the Soviet

Union, and Poland of \$47 million, \$469 million, and \$103 million respectively.

Eximbank examines loan applications on a case-by-case basis. Approvals or rejections are based on various internal criteria. Its files contain almost no documentation on reasons for approving the financing for specific transactions so it is unclear which of its criteria is most important. The absence of specific criteria for determining whether to approve financing also makes it difficult, if not impossible, to assert that the Soviet Union is or is not receiving preferential treatment.

Eximbank's analysis of creditworthiness of Communist countries has been hampered by the lack of some financial information requested. Its unique agreements with Poland and the Soviet Union provide that only their respective Banks for Foreign Trade can apply to the Bank for financing of potential transactions. Thus, U.S exporters or the commercial banks representing the exporters are precluded from applying for Eximbank financing. (See pp. 14 to 22.)

3. Commodities and technology considered to be of strategic importance are subject to U.S. national security export controls. However, there are significant limitations on the administration of export control regulations and procedures because of major differences between executive agencies on how these are interpreted. Commerce seeks to promote American exports, Defense to protect U.S. security interests, and State to enhance diplomatic objectives. Regulations on the transfer of technology are unenforceable. The existence of two separate export control review committees which differ only slightly in their activities is not justified. Differing departmental priorities have resulted in a

continuous pattern of ad hoc decision-making and fragmented consideration of strategic export controls. (See pp. 26 to 38.)

U.S. officials directly concerned with export control issues have little confidence in the multinational Coordinating Committee system for controlling strategic exports. U.S. export control and foreign policy decisionmaking work against maintaining a multilateral consensus on the importance of strategic export controls. (See pp. 42 to 49.)

4. There is an absence of precision and consensus within the executive branch about what U.S. diplomatic objectives are, whether they have been or are being achieved, or what they would be worth if forthcoming. Accordingly, little information was publicly available from the Government on these matters.

It is doubtful whether trade can become a useful diplomatic instrument in U.S.-Soviet relationships unless the executive branch achieves a meaningful consensus on objectives and takes a more direct role in using the leverage of providing export credits and access to U.S. commodities and technology. The American public and Congress should have a greater awareness of both facts and objectives. (See pp. 52 to 54.)

The expansion of U.S.-Soviet trade requires a greater U.S. effort to improve the balance of commercial benefits by matching the concentrated negotiating power of the Soviet Union under its centrally planned economy. Given the nature of the Soviet system, U.S. response to the imbalance in negotiating strength must be through more effective and increased executive branch involvement in both bilateral and multilateral trade relationships. (See pp. 54 to 59.)

Recommendations

GAO is making a series of recommendations for the subject areas below to the executive branch agencies and policy councils concerned

with East-West trade. These recommendations are intended to:

Policy formation, decision-making, and capacity to achieve reciprocity of benefits

(See p. 10 and pp. 61 to 65.)

- Improve executive branch understanding of the nature and implications of differences between the economies of the Western world and those of the Communist countries.
- Obtain improvements in Communist countries' commercial practices.
- Increase the degree of executive branch involvement in U.S. company-Communist country commercial negotiations in order to fully protect U.S. national interests and to permit more direct and effective support for commercial interests.
- Reduce the present fragmentation in policy formation by granting the East-West Foreign Trade Board full responsibility for determining broad policy objectives and devising implementing plans and programs.
- Upgrade the executive branch's data collection, analytical capabilities, and coordination.
- Achieve greater Western multilateral coordination to develop unified objectives and implementation programs for trade with Communist countries.

Export promotion and financing

(See p. 14 and pp. 24 and 25.)

- Increase the executive branch's ability to respond to the needs of U.S. businessmen by improving the flow of information on Communist countries' import needs, currency allocations, and financial positions.
- Make Eximbank more responsive to U.S. exporters by renegotiating the operating agreements with Poland and the Soviet Union to

permit U.S. exporters to apply for financing of potential transactions.

- Improve Eximbank's approval of financing applications by establishing more precise criteria and providing for better analysis and documentation.
- Provide that the authorization of loans for other than economic reasons require specific Presidential and congressional approval.
- Achieve multilateral Western treatment of the Soviet Union as a wealthy country in agreements on harmonization of export credit terms.

Export controls and technology exchanges
(See pp. 39 to 41 and pp. 50 and 51.)

- Strengthen the Department of Commerce's role in upholding and licensing national security-controlled commodity exports.
- Alter the Department of State's role in export controls to conform with the lead-role concept for Commerce and expand State's monitoring role in technology exchanges.
- Improve executive branch understanding of international technology transfers and their impacts on national security and the domestic economy, including the objectives, organizational requirements, and responsibilities for monitoring such transfers.
- Clarify the Department of Defense's responsibilities in formulating and reviewing export controls.
- Have the Department of State consider the effects of liberalized trade with Communist countries on the continuance of the international Coordinating Committee system for multilateral strategic export controls.
- Ensure that U.S. interagency positions on major foreign exception cases are consistent with positions on U.S. cases and are supported by foreign policy decisions.

--Ensure that the necessity and value of a multilateral consensus on export controls is carefully weighed against U.S. national security interests.

Executive branch comments

A single, coordinated executive branch response to our report was received from agencies of the East-West Foreign Trade Board and the Department of Defense. (A separate response from the Central Intelligence Agency indicated no substantive disagreement with the report.) The Board's response was not intended to comment specifically on all the detailed matters contained in the report. It stated that the tone of the report was misleading in some instances and that many of the major conclusions were unsupported by the facts.

The response addressed, in overall terms, the pertinent issues as the Board viewed them. However, the comments were not fully responsive to the issues raised by GAO. The lack of commentary on specific matters in the report was not intended to indicate the Board's agreement with the information provided, conclusions reached, or recommendations made. Accordingly, although the Board indicated concurrence with some recommendations, they were not identified and the response offered no indication of any implementing actions. The Board argued that realistic and effective East-West trade policies and procedures were in existence.

Detailed comments on GAO's evaluation are included at the end of appropriate chapters. (See pp. 9, 22, 38, and 59.) A copy of the Board's response is included as appendix 7.

Matters for Consideration of Congress

This report should be helpful to Congress in analyzing the issues involved in bilateral and multilateral East-West trade and in responding to various legislative needs.

Congressional deliberations should consider GAO's recommendations for improving executive

branch agencies' capabilities for dealing with East-West trade issues and the need for legislation identified in this report. Congress should also consider:

1. Establishing procedures for congressional involvement in executive branch foreign trade and economic activities, including bilateral negotiations. (See p. 10.)
2. Establishing a procedure for unified consideration of the linked political, strategic, and economic issues involved with East-West trade which are currently within the jurisdiction of various legislative committees. (See p. 10.)
3. Examining the administration of national and international export controls and technology export exchanges and the implications for national security and the domestic economy. (See pp. 39 and 49.)

CHAPTER 1

INTRODUCTION

Beginning in about 1969, the United States embarked on a foreign policy designed to normalize relations with the Soviet Union, the People's Republic of China, and the Communist countries of East Europe. ^{1/} This effort became known as detente--a relaxation of international tensions--and encompassed a broad range of political and economic considerations.

Congressional and public interest focused on the renewed trading relationships and the role of trade in detente. Little information was publicly available from the Government on the actual benefits, objectives, and policies and on the executive branch's capacity to deal effectively with the bilateral and multilateral relationships of such trade.

We, therefore, undertook to provide a report to Congress which would contain information on and an assessment of these matters. This summary is an unclassified version of the information provided to Congress on (1) U.S. trade policy and the policy formation process, (2) export promotion and financing programs, (3) export controls and technology, and (4) the balance of diplomatic and commercial benefits.

Information for the study was obtained through extensive interviews with Government and business officials in the United States and abroad and through an examination of records at the key agencies in Washington. Restrictions placed on our access to individuals and records precluded as comprehensive an examination as was warranted in certain areas. See chapter 7 for the scope of our review and the restrictions on access.

^{1/}East Europe as used in this summary refers to Bulgaria, Czechoslovakia, East Germany, Hungary, Poland, and Romania.

CHAPTER 2U.S. TRADE POLICY ANDTHE POLICY FORMATION PROCESS

U.S. relations with Communist countries involve many and varied national considerations, the nature of which link diplomacy, national security, economics, and technology. Since World War II, repeated efforts have been made to achieve a constructive relationship and have continuously focused on United States-Soviet relations.

In this renewed relationship, the current assumption is that Communist countries are willing to develop and maintain constructive and harmonious relationships for economic gains. U.S. objectives are to achieve a broad normalization of relations, thereby creating a cooperative environment, an incentive for responsible and restrained international conduct, and opportunities for economic benefits.

ADMINISTRATION INITIATIVES

In 1969, the Nixon Administration began implementing a foreign policy designed to normalize diplomatic, strategic, and economic relations with Communist countries. The policy adopted was developed within the National Security Council (NSC) and Council on International Economic Policy (CIEP), an interagency decisionmaking structure which basically has a political rather than an economic context. The strategy sought progress on a broad range of issues and was based on the conviction that progress in one area added momentum to progress in others. Trade liberalization was seen as an incentive for improved cooperation in political and strategic relations.

The policy adopted was that progress on political and strategic issues would precede progress on economic issues, with trade being the policy instrument used to achieve political progress. A general political/economic linkage was established. No specific political/economic linkages have ever existed, according to present executive branch officials.

The Soviet Union has been the central focus of U.S. efforts to improve relations with Communist countries since World War II. Soviet relations with other Communist countries have determined the pace of these countries' efforts to expand trade with Western nations, and current U.S. policy reflects these considerations. The Nixon Administration began moving on trade issues first with the Soviet Union

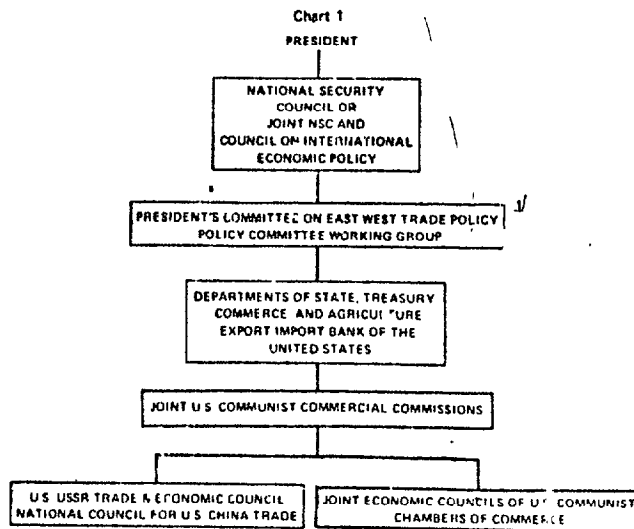
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and then, on the basis of political importance, with other Communist countries. This policy is recognized as being less applicable to the People's Republic of China.

To support the foreign policy initiatives, as well as to enhance the purely commercial benefits of trade, the executive branch created Government and private sector institutions to promote, facilitate, and monitor trade with Communist countries. The Government's involvement in creating such institutions recognized that trade with nonmarket economies differed from trade with traditional U.S. trading partners and reflected the desire that detente not be harmed by trade barriers.

A new Bureau of East-West trade was created within the Commerce Department, an interagency Policy Committee was appointed to advise the President on East-West trade issues, and a series of bilateral commercial, agricultural, and technological commissions and agreements were made between the United States and Communist countries. These actions enabled the Government to assist businesses interested in trading with Communist countries, to coordinate East-West trade policy, and to more directly manage the trade relationships.

The following chart shows the basic trade policy decisionmaking process. It reflects the structure used within the Nixon Administration. The Ford Administration has basically maintained the structure; however, several new White House organizations may play an increasingly important role in developing trade policy.



Now The East West Foreign Trade Board

Source: Prepared By GAO From Information Provided By Executive Agencies

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The Economic Policy Board (EPB), established by President Ford on September 30, 1974, and chaired by the Secretary of the Treasury, is the present focal point for formulating, coordinating, and implementing all economic policy within the U.S. Government.

The President issued Executive Order 11846 on March 27, 1975, which implemented several provisions of the Trade Act of 1974 related to East-West trade. The Executive Order converted the President's former Committee on East-West Trade Policy into the East-West Foreign Trade Board. The Secretary of the Treasury is also chairman of this Board, and the Assistant to the President for Economic Affairs is the deputy chairman. Other members include the Secretaries of State, Agriculture, and Commerce; Special Representative for Trade Negotiations; Director of the Office of Management and Budget; Executive Director of the Council on International Economic Policy; and the President of the Export-Import Bank of the United States.

The Board is expected to perform functions previously handled by the President's Committee on East-West Trade Policy. It will insure that trade between the United States and nonmarket economies is in the U.S. national interest and receive reports from (a) private industry on exports of technology vital to the U.S. national interest and (b) Government entities on extensions of credits, guarantees, or insurance to Eastern countries in excess of \$5 million during any calendar year. It will also report quarterly to Congress on U.S. trade and bilateral economic activity with nonmarket economies. The Board, however, will not advise the President on sections of the Trade Act which deal with freedom of emigration and the related extension of most favored nation tariff status, as these matters have been left to the Secretary of State to discharge. In connection with the Board's obligation to receive reports on exports of technology vital to the U.S. national interest, the Board will rely on the information generated through the Commerce Department's export control system.

The vast number of committees, working groups, and executive branch organizations concerned with East-West trade issues are composed generally of the same membership as the East-West Foreign Trade Board. Although principal policy operations are developed on an interagency basis, East-West trade issues have been handled in many different ways, with no consistent pattern of study, analysis, and decisionmaking. Generally, issues have been reviewed by (1) ad hoc interagency groups under the Policy Committee, (2) task forces directed by a single department, or (3) interagency task forces operating under CIEP or NSC.

The decisions to delay and renegotiate the October 1974 Russian grain purchases were made within the Economic Policy Board's Committee on Food, composed of its Executive Committee supplemented by State and Agriculture representatives. An interagency Deputies Group on Food prepared the basic staff analyses and option papers for higher level review and decisionmaking.

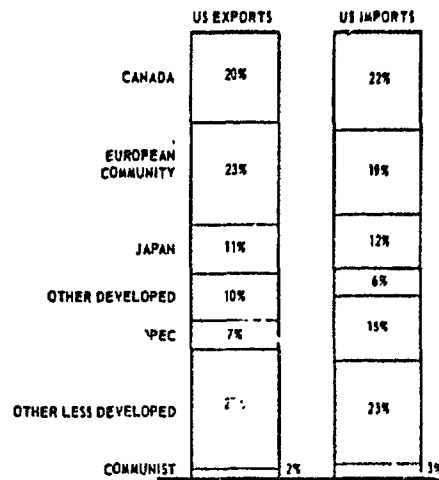
The initiative and decisions which resulted in negotiation of the October 1975 long-term grain supply agreement between the United States and the Soviet Union were made within the framework of the EPB-NSC Food Group established in September 1975. This initiative represents a change in previous executive branch policy in recognition of the need for Government involvement to protect the U.S. grain market from the enormous variation in Soviet grain purchases from year to year. Previously, Agriculture was able to successfully oppose restrictions on Soviet open access to U.S. grain markets. Since formation of the EPB-NSC Food Group, the Deputies Group on Food has been relegated to improving executive branch agricultural forecasting and no longer provides analyses and option papers for general agricultural policy matters.

The interagency process has not insured that agency positions are clearly defined and properly analyzed before decisions or implementation plans are made. Moreover, once an agency has been given or has assumed the lead in particular negotiations, there has been no guarantee that true interagency consultations will occur. This is principally because of differences about the reasons for improving United States-Communist relations and because of the power and influence of cabinet and other senior-level advisers. These reasons have frequently determined the ultimate direction of policy and are evidenced in determining the U.S. position in Soviet lend-lease negotiations, Soviet grain purchases in 1974, and U.S. economic policies toward Eastern Europe.

TRADE PROGRAM PLANNING

No planning program with specific and clearly defined commercial objectives for U.S. trade with Communist countries has been developed. Country commercial programs, which ordinarily reflect coordinated consideration of U.S. trade objectives and activities for attaining them, are not prepared for Communist markets. As shown below U.S. trade with Communist countries approximates only about 2 percent of U.S. exports and 3 percent of imports.

U.S. TRADING PARTNERS, 1974



Source: CIEP Annual Report - March 1975

Although we did not have complete access to all inter-agency studies, the NSC and CIEP studies we reviewed did not develop trade strategies and implementation plans. They did concern issues involved in normalizing economic and commercial relations and in establishing a framework within which private American firms could participate in trade with Communist countries.

We were advised that the Ford Administration presently has a unified set of objectives in East-West trade. These objectives are to (1) eliminate the freedom of emigration requirements (Jackson-Vanik Amendment) in the Trade Act, (2) eliminate the restrictions on extension of U.S. export financing, (3) continue to press for greater U.S. markets in Communist countries, and (4) obtain the economic benefits associated with increased exports. The East-West Foreign Trade Board has emphasized that favorable action by Congress on trade matters would depend to a large degree on Communist countries' actions and policies in other areas of detente.

Chapter 6 of this statement discusses the balance of diplomatic and commercial benefits and contains recommendations for improving the process of policy formulation and decisionmaking for U.S. trade with Communist countries.

CONGRESSIONAL CONSULTATION

Congress has constitutional responsibility for regulating trade. It delegates administration of this responsibility to the executive branch, which has the constitutional responsibility for negotiating with foreign governments. No clear guidance and interpretation exists on the President's

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authority to conduct trade-related discussions in periods when there is no congressional delegation of this authority. When the President's authority to implement the results of trade negotiations expires as it did in 1967, trade issues have been discussed or negotiated using Presidential authority for negotiating with foreign governments.

Even though it is clear that trade negotiations are within the traditional purview of Congress, initial negotiations with the Soviet Union took place without prior consultation or cooperation with Congress. This type of negotiation contributed to subsequent disagreements between the President and Congress on trade issues.

During 1969-74 when the overall policy and framework for East-West trade was established, the President conducted discussions and negotiations without seeking the consent of Congress, but generally kept congressional leaders informed. The President generally made agreements on trade and foreign economic issues in one of three ways.

1. Agreements under authority granted him by other trade legislation; for example, the 1972 agreement with the Soviet Union on reciprocal financing procedures was entered into on the basis of the Presidential national interest determination as required by the Export-Import Bank Act.
2. Agreements which require congressional action to become effective; for example, the 1972 trade agreement with the Soviet Union and the 1974 claims agreement with Czechoslovakia.
3. Agreements on his sole authority; for example, the 1974 long-term agreement with the Soviet Union to facilitate economic, industrial, and technical cooperation.

The Case Act was passed in 1972 because of congressional concern over the increased use of executive agreements in foreign affairs, such as those used in establishing trade relations between the United States and the Communist countries. Although this act requires the Secretary of State to submit all international agreements to Congress for its information, there are differences of opinion between Congress and the President regarding the scope of the act.

Congress can require information and hold hearings on foreign economic and trade issues, but it has not exercised this authority with regard to overall East-West trade issues until recently. To exercise its oversight and consultation

role, Congress must have information from those involved in making foreign economic decisions. It neither received information nor held hearings on the initial policy studies and decisions on U.S. trade with Communist countries. The initial policy studies were made within the NSC or joint NSC/CIEP policy structure, and all information on these studies which we reviewed was classified and held very tightly within the executive branch. We are unaware that any substantial amount of this information was made available to Congress. Various agency officials told us that the executive branch consults generally with Congress on the basis of what it believes Congress wants to know and when it is necessary.

Senior NSC and CIEP officials directly involved with reviewing the policy studies and making decisions or recommendations to the President have not been called to testify on the substance of the studies or the reasons behind the decisions. It is unclear whether senior White House officials would agree to testify on such matters or would seek to invoke executive privilege.

Because the political, strategic, and economic issues involved in U.S. trade with Communist countries are not within the jurisdiction of any single committee, Congress cannot play an effective oversight role. There is no comparable group to the NSC/CIEP policy structure for East-West trade issues. We were advised by agency officials that congressional leaders and committee chairmen have been briefed on executive branch actions, but we were not provided with evidence of the substance of such briefings, the amount of data provided to other Members of Congress, and the extent of congressional debate.

Congressional representation has not been included in U.S. delegations to Communist countries when trade or foreign economic discussions have occurred. Bilateral organizations, such as the Joint U.S.-U.S.S.R. Commercial Commission and the American-Romanian Economic Commission established by the President for negotiating commercial agreements and monitoring commercial relationships, did not provide for direct congressional involvement. Moreover, there is no procedure for consultation between executive and congressional staffs which would enable Congress to effectively monitor executive branch discussions on East-West trade. Actual congressional participation in bilateral negotiations may be infeasible, but general agreement on basic executive branch positions prior to negotiations could be desirable. This would require the executive branch to provide information on and to discuss relevant issues with at least appropriate committee chairmen and ranking members.

If trade with Communist countries is to be used to seek national interest objectives, the American public and Congress, in addition to the involved executive branch agencies, should be presented with the problems, opportunities, and national interests involved. The advantages of such trade to the United States are not widely appreciated and a greater awareness of both facts and objectives is needed. The executive branch, therefore, should make explicit what it intends to do and what it seeks to accomplish.

AGENCY COMMENTS AND OUR EVALUATION

The East-West Foreign Trade Board's response charged that the overall classified report (1) contained unsubstantiated allegations on the lack of coordination, failure to formulate clear goals, and inadequate implementation of policy caused by the lack of an overall Government strategy and interagency conflict, and (2) failed to recognize the strength of interagency committees and boards and that these groups have served to ensure that major policy initiatives are consistent with the principal economic, political, and military objectives pursued by the U.S. Government.

The response admitted there was imperfect interagency coordination, analyses, and decisionmaking in 1972, but said the decisionmaking process has been improved and strengthened since then through the establishment of the East-West Trade Policy Committee and its successor organization, the East-West Foreign Trade Board.

We agree that there have been some improvements in these areas since 1972, but there are still many problems to be resolved and issues to be addressed. Examples cited in the report involved the 1974-75 period. Most importantly, the principal economic, political, and military objectives referred to as being pursued have not been clearly defined and plans and programs devised to achieve them are equally ambiguous. Moreover, basic issues, such as the Government's role in the trade relationship, relative priority of objectives, consultation with Congress, criteria and standards for export controls, and implications of the linkage concept, have not been fully assessed.

The Board said that the report exaggerated the significance of U.S. trade in the process of detente and, thus, the degree to which trade can be used as a lever to exact concessions. It said that while trade may improve the environment for progress on political issues, trade is not the policy instrument used to achieve political progress.

The importance attached to trade as a factor in detente by the executive branch is amply demonstrated by a variety of actions including (1) the establishment of a separate Bureau of East-West Trade in Commerce, (2) formation of the President's Committee on East-West Trade, (3) establishment by the Government of the various Joint Commissions, and (4) national interest determinations made by the President to make the Soviet Union, Poland and Romania eligible for Government financing. Executive branch actions and studies have been clearly characterized by a concern that adverse decisions on trade matters could interrupt the momentum of detente.

We appreciate the limitations of trade as a lever to exact concessions. We indicate in chapter 6 that trade, in theory, could help shape Soviet diplomatic behavior but that its influence was indeterminant. The most important limitation on trade being used to exact concessions is the failure of the executive branch to recognize the unique character of East-West trade (imbalance in bargaining leverage) and to take a more direct role in identifying desired concessions and controlling the sources of U.S. leverage. As a practical matter, there is no evidence that the executive branch has consciously tried to manipulate trade in exchange for specific diplomatic concessions. Executive branch officials advised us there are no specific linkages between U.S. trade initiatives and Soviet diplomatic behavior.

MATTERS FOR CONSIDERATION OF CONGRESS

Clearly established procedures are needed for congressional involvement in the President's foreign trade and economic negotiations. To accomplish this, Congress may wish to consider establishing a joint executive-congressional group to consult to reach agreement on (1) Presidential authority for negotiating trade and economic issues in the absence of a congressional delegation of authority or declaration of intent to implement negotiation results and (2) procedures for:

- Congressional participation in planning for such negotiations.
- Congress to receive information and to question those involved in executive branch studies, decisions, and negotiations.
- Resolving questions on the doctrine of executive privilege.
- Congressional consultations on positions to be taken in meetings of bilateral organizations,

such as the Joint U.S.-U.S.S.R. Commercial Commission.

- Formal and institutionalized staff interchanges of data and ideas on East-West trade studies, reviews, and evaluations.

East-West trade involves political, strategic, and economic issues which are not within the jurisdiction of any single congressional committee. Congress should also consider establishing a procedure for consideration of the linked issues involved with East-West trade. Such a procedure would evidence congressional interest, involvement, and authority and would tend to clarify congressional responsibility and authority for foreign trade and economic matters to foreign governments.

CHAPTER 3

U.S. EXPORT PROMOTION AND FINANCING PROGRAMS

The traditional market forces that function in capitalist nations do not function freely in Communist economies, so the decision to expand East-West trade required that the executive branch take a more active role in promoting and financing such trade. American businessmen had to be educated in the ground rules under which trade with Communist states is conducted, and the nonconvertibility of Communist currencies created difficulties in paying for U.S. goods. The extension of export credits by the Export-Import Bank (Eximbank) and the Commodity Credit Corporation (CCC) has provided Communist countries with the primary means of paying for Western goods and technology.

PROMOTIONAL ACTIVITIES

The executive branch's active role in promoting trade with Communist countries is evident in the trade agreements with the Soviet Union and Romania and in the establishment of Government (Joint Commercial Commissions) and private sector (National Council for U.S.-China Trade) organizations. The Bureau of East-West Trade was established within Commerce in November 1972 to promote the orderly development of U.S. economic relationships with Communist economies and to continue Commerce's responsibility for implementing and enforcing the U.S. export control system. Traditional export promotion activities of Commerce's Bureau of International Commerce were adapted to Communist markets by the Trade Promotion Division of the Bureau of East-West Trade.

As an intermediary in helping American businessmen, the Bureau of East-West Trade:

- Provides information, advice, and assistance on various aspects of commercial undertakings in Communist countries.
- Offers market information and analyses.
- Reports on current trade opportunities in Communist markets.
- Arranges person-to-person contacts with Communist trade officials.
- Helps firms to take part in trade fairs, exhibitions, and missions to acquaint Communist officials with their products.

--Issues publications on Communist trade practices and economic plans.

The Bureau's promotional activities have included supporting U.S. firms in specialized trade missions, technical sales seminars, and international and solo trade and industrial exhibits. Certain types of missions have experienced problems.

Executive-level missions have succeeded in promoting contacts between senior executives of U.S. firms and high-level government officials of three Communist countries. However, the manner of selecting participants (primarily through telephone solicitation) and the appropriateness of such missions is questionable.

A key U.S. Embassy official opposed such a mission in his assigned country, because he felt top executives of large U.S. companies could effectively deal with East European government officials without the sponsorship of the U.S. Government. Further, he felt that host-country officials might perceive the U.S. Government as favoring the participating firms. Bureau officials advised us that they were unaware of any such problems. However, they said no executive-level missions to Communist countries were presently scheduled for fiscal years 1976 and 1977.

Industry-organized, Government-approved missions are formed with the advice and support of Commerce. Although the products represented in such missions are supposed to be a homogeneous group within one product theme, such has not always been the case. Missions with diverse product lines have created a burden on Embassy officials but generated few sales. Their effectiveness in Communist countries where the governments create the markets is questionable. Bureau officials said their ability to control the makeup and destination of the missions was limited because the missions are organized by an industry or State outside Commerce's purview and there usually was strong domestic pressure to approve the missions.

The lack of information on import plans, hard currency reserves, and currency allocations for planned imports has presented substantial obstacles to Government and private business efforts to develop meaningful market research data in Communist countries. Such data is necessary if the U.S. Government is to continue encouraging U.S. firms to enter Communist markets. Commerce can probably play a more important market research role because U.S. officials are able to identify, and have relatively free access to, appropriate foreign trade officials.

RECOMMENDATIONS

The Secretary of Commerce should:

- Evaluate the appropriateness of executive level trade missions and improve the manner of selecting representatives.
- Evaluate the effectiveness of industry-organized Government-approved trade missions to Communist countries.
- Press the Communist countries for information on import needs and hard currency allocations for these imports.
- Devote efforts necessary to fulfill Commerce's realizable potential in developing market research data.

EXPORT FINANCING

Communist currencies are not freely convertible into Western currencies. Limited reserves of hard currencies in Communist countries has made paying for Western imports a significant problem. Western nations' extension of most-favored-nation tariff treatment, barter deals, joint ventures, and product-payback contracts are all attempts to respond to this problem. The availability of Eximbank and CCC export financing has probably been the most significant stimulator of U.S. trade with Communist countries. The obvious exception is exports to the Peoples' Republic of China because it has generally been reluctant to use long-term credits from any nation. In addition, the problem concerning previously extended U.S. export credits to China and other U.S. private claims and the linked issue of Chinese assets blocked by the United States must be resolved before the People's Republic would be eligible for export financing.

Eximbank

Making Eximbank's export credit facilities available to a Communist country requires a Presidential determination that such action is in the U.S. national interest. The Department of State has taken the lead in advocating these determinations as the availability of Eximbank facilities for Communist countries has been and continues to be addressed as a foreign policy consideration. Since the time that the President's national interest determinations were made for Romania, the Soviet Union, and Poland, Eximbank has extended direct loan credits to them amounting to \$47 million, \$469 million, and \$103 million, respectively.

Eximbank transactions with Communist countries have been minimal since mid-1974 due to (1) increased congressional criticism, (2) extension of its operating authority on a temporary basis from July to December 1974, and (3) restrictions on its activity in Communist countries. The restrictions resulted from passage of the Eximbank and Trade Acts in December 1974, which made Poland the only Communist country eligible for Eximbank financing. The signing of a bilateral trade agreement with Romania in 1975 met the conditions specified by that legislation and restored Romania's eligibility for Eximbank financing. The Soviets refused to implement the 1972 U.S.-Soviet Trade Agreement, because of legislative provisions related to freedom of emigration requirements.

Approval of financing

The basic purpose of Eximbank is to aid in financing and to facilitate U.S. exports. It is supposed to meet competition of export-financing institutions of other major Western nations and to supplement and encourage, but not compete with, private export capital. In addition, Eximbank must ascertain that its loans offer reasonable assurance of repayment.

Credit applications are examined on a case-by-case basis and preliminary commitments or loan authorizations are issued. An application for a loan authorization does not have to be preceded by a preliminary commitment, but it generally is in transactions with Communist countries eligible for financing.

Eximbank has agreements with Romania, the Soviet Union, and Poland on procedures for applying for its financing. The procedures for the Soviet Union and Poland are unique in that they permit only the respective Banks for Foreign Trade to apply for preliminary commitments. Normally, the U.S. exporter or the commercial institution representing the exporter applies for preliminary commitments. 1/

U.S. suppliers may invest substantial time and money in designing projects on the basis of the issuance of a preliminary commitment to finance it. This could increase the pressure on Eximbank to authorize the loan. In addition, since the governments of the Soviet Union and Poland are the applicants for financing, Eximbank denial of a loan authorization for which a preliminary commitment had already

1/An indication that Eximbank will proceed expeditiously to obtain formal and final approval when the specified conditions of the commitment have been met; a preliminary commitment is not legally binding, but in the words of an Eximbank official, "it is a kind of a moral obligation."

been issued presents obvious foreign policy implications. This has happened only once, in regard to Poland. Eximbank's issuance of a preliminary commitment, therefore, not the loan authorization, is most significant in these cases and a rigorous analysis should support its approval.

There are no comprehensive guidelines for determining whether to issue a preliminary commitment but Eximbank officials indicated the following criteria were generally applicable.

- Financial condition of purchaser.
- Creditworthiness of country.
- Foreign competition.
- Willingness of private commercial banks to participate.
- Technical feasibility of project.

There have been conflicting statements as to which of these criteria are paramount. Eximbank officials have stated that a preliminary commitment is issued only if it is determined that Eximbank financing is essential for the U.S. exporter to consummate the sale. This indicates that foreign competition and willingness of private commercial banks to participate are most important. However, a former Eximbank senior vice president wrote that the decision to finance was based on an assessment of the creditworthiness of the purchasing country. Eximbank's Board of Directors decide on preliminary commitment applications on the basis of the judgment of the individual Board members, who rely for technical support on information contained in the Preliminary Commitment Memorandum.

We examined Eximbank's issuance of 16 preliminary commitments to the Soviet Union--totaling about \$469 million--according to the criteria. We did not evaluate the quality or depth of the analysis on the technical feasibility of financed projects.

Since the Communist governments are the actual borrowers, the creditworthiness of the purchasing country is an important factor in analyzing whether the commitment should be made. Information on the international financial position of the Soviet Union, Poland, and Romania has been difficult for Eximbank to obtain. State secrecy laws prohibit disclosure of some required data (for example, the hard-currency reserve data of the Soviet Union). Recently, however, Romania joined

the World Bank and the International Monetary Fund, which resulted in a considerably freer flow of Romanian balance-of-payments information. Poland's recent heavy participation in Western capital markets has led to greater availability of information on its financial position.

Financial data requested from the Soviet Union, however, has not been forthcoming. The Soviets have not made balance-of-payments data available to any of its Western creditors, some of whom have considerably larger exposures in the Soviet Union than Eximbank does. The Soviet Union probably is a better credit risk than are individual importers or some other countries. However, receipt of this information is necessary if Eximbank is to apply the same standards for judging credit-worthiness as it applies to other borrowers and to answer criticism of providing preferential treatment.

Eximbank credit must be competitive with that offered by other Western nations whose exports compete with U.S. exports. Eximbank officials have argued that Eximbank should be competitive generally with the credit institutions of other countries. They do not believe, however, that the burden should be on Eximbank to show that there was, in fact, foreign competition on a financed transaction.

Eximbank files for the 16 Soviet loans contained little documentation of competition by foreign exporters. 1/ There was no evidence that the informal system of the Berne Union 2/ had been used or that U.S. Embassies had been requested to provide such information. Although lack of documentation does not necessarily indicate there was no real competition on a particular transaction, the possibility exists. For example, the Preliminary Commitment Memorandum on the sale of submersible electric pumps (a \$12-million loan) stated that Eximbank participation was necessary in order to have a financial assistance offer which could compete with the terms and conditions of other offers. However, the U.S. exporter of these

1/In an earlier report, "Improved Management Information System Needed for Eximbank's Capital Loan Program (B-114823, Feb. 12, 1973), we similarly criticized the lack of documentation for such factors as foreign competition and private financing and recommended that Eximbank improve its procedures. In this review, our criticisms are based on examination of the files for 16 loans in 1973-74 to the Soviet Union. Eximbank officials noted, however, that loans to other countries during this period were analyzed and approved in a manner similar to Soviet loans.

2/An unofficial group of credit insurers, who, among other things, make available to each other the terms of credit provided to borrowers.

pumps told us that there were only four manufacturers of this type of equipment in the world, all located in Oklahoma. Even when foreign competition exists, the U.S. exporter sometimes has a competitive advantage and this should be considered in determining the rate and extent of Eximbank's financing of the transaction. A more flexible maximum rate should be established and applied to sales that do not require a concessional interest rate to the buyer but for which capital may be required. We recommended in another report that Eximbank raise its interest rate on direct loans to finance sales for which little or no foreign competition exists to the rate charged by commercial lenders. 1/

The Soviet transaction files contain little information documenting conclusions by the Eximbank staff that private sources of financing might not be available. During the period of approval for Soviet loans, Eximbank's policy of 45-percent participation in the financing package, rigidly applied, provided no incentive for its officials to examine each case separately to determine the extent to which private commercial banks might have participated. Thus, there is no certainty that Eximbank has not competed with private capital or displaced cash sales--for instance on projects having priorities in Communist countries or for which there is no alternative source of supply. Since mid-1974, Eximbank operations with the Soviet Union have been suspended and millions of dollars have been paid in cash to U.S. exporters for equipment. Also, the Soviets appear to prefer to pay cash when interest rates reach a certain level.

Eximbank's present administration adopted a more flexible policy in mid-1974, which included a 30 to 45 percent range of participation. This policy should provide the incentive for Eximbank to examine each case more thoroughly to determine the necessity and extent of its participation.

The lack of documentation in the Soviet transaction files is understandable considering the rapidity with which preliminary commitments have been analyzed. The Eximbank case officer and support staff prepared 12 of the 16 Soviet preliminary commitment memorandums within 3 days or less. Only the memorandum for the Moscow trade center, a \$36 million loan, was dated more than 2 weeks after the request for a preliminary commitment was received. The short time frame should be considered in the light of Eximbank's overall policy under its previous administration that there should be a 2-week turnaround time. Under the present administration, no desired turnaround time is specified.

1/Weakened Financial Condition of the Export-Import Bank of the United States (ID-76-17, Oct. 17, 1975).

Agency involvement in
Soviet financing

The National Advisory Council on International Monetary and Financial Policies (NAC) and the President's Committee on East-West Trade Policy (now the East-West Foreign Trade Board) are the interagency groups concerned with Eximbank approval of preliminary commitments and authorizations of loans to Communist countries.

NAC

NAC is composed of representatives of the Departments of State, Treasury, and Commerce; Federal Reserve Board; and Eximbank and operates under executive order to coordinate the policies and operations of international financial organizations, including Eximbank. It reviews individual agency financial policies and advises on their consistency with overall U.S. international financial policies on credit, investment, and development. NAC has no independent staff, so its work is done by the individual agency members.

A Treasury staff committee member said that the financing of exports to Communist countries was discussed only in the context of specific transactions. Committee minutes contained few details on issues raised during meetings. The current NAC approval process is really a formality which lacks substance.

President's Committee

Through the forum provided by the President's Committee on East-West Trade Policy, executive agencies have influenced Eximbank financing decisions. Committee members urged approving one transaction for which Eximbank might have denied financing.

Eximbank officials told us that the Soviets orally raised the question of Eximbank financing for the Moscow trade center in August 1973. A senior bank official gave an immediate negative reaction, noting the bank's preference for industrial rather than real estate projects. Eximbank had previously disapproved a similar project and hoped to deter the Soviets from formally applying for a preliminary commitment. The Soviets subsequently appealed to Treasury and Commerce officials, who urged Eximbank to reconsider the request; it was approved in December.

Committee influence was also present in the acetic acid plant project. Eximbank files for this project contained letters from U.S. participating companies addressed to the Chairman of the Committee, which were sent at the suggestions

of Commerce and Treasury officials. The letters noted that (1) Commerce and State had encouraged the companies to seek opportunities for exporting complete plants to the Soviet Union, (2) when the acetic acid project was identified, Commerce and State urged the companies to pursue it, and (3) Eximbank had been contacted periodically during the past 2 years and had assured the companies that financing would be available. Eximbank officials denied that such assurances were given; however, it is clear that the companies had received the impression that financing was assured.

These events highlight certain difficulties in Eximbank financing. They show that the Soviets have been able to solicit the support of executive agencies in their dealings with Eximbank and that these agencies gave assurances to Soviet officials and/or U.S. companies that Eximbank financing would be available. This created a momentum for approval which Eximbank may have found difficult to counteract.

These events also show that the absence of specific criteria for determining whether to approve financing makes it difficult, if not impossible, to assert that the Soviet Union is or is not receiving preferential treatment. If preferential treatment is to be given, in our opinion, there should be a Presidential national interest determination, regardless of the U.S. export value of the transaction. Congress should approve such cases and the public record should show that Eximbank financing was based on economic or other considerations. 1/

There has been congressional speculation that Eximbank had opened a line of credit to the Soviet Union. This is understandable in that no preliminary commitment requests from the Soviets have ever been denied. There are also indications that the Soviets interpreted certain statements by executive branch officials, including Eximbank, as meaning that a line of credit (\$500 million) had been opened to them. Evidence shows, however, that Eximbank has approved preliminary commitments and loan authorizations on a case-by-case basis.

Eximbank responsiveness
to U.S. exporters

Basic agreements on financing procedures between Eximbank, the Soviet Union, and Poland provide that only the

1/The Export-Import Bank Amendments of 1974 (Public Law 93-646) require a separate Presidential national interest determination for each transaction in which Eximbank would extend a loan of \$50 million or more to a Communist country.

respective Banks for Foreign Trade can apply for preliminary commitments from Eximbank. U.S. companies active in Moscow and Warsaw told us they would prefer to obtain preliminary commitments from Eximbank in order to be able to present a total package, including financing, at the negotiating table. One business representative in Moscow stated flatly that the Soviets controlled Eximbank financing because exporters are obliged to have the Soviets make the requests for Eximbank financing.

U.S. exporters, especially small- and medium-sized firms, probably have been denied opportunities to seriously compete for Soviet sales since they must compete with exporters of other Western nations whose credit institutions offer favorable credit terms. U.S. exporters are unable to take advantage of Eximbank financing unless the Soviets consider the sale of sufficiently high priority to warrant applying for a preliminary commitment.

U.S. companies are most likely to have a competitive advantage on larger projects. Although the Soviets are probably most anxious to obtain Eximbank financing for these projects, it is for them that the essentiality of Eximbank assistance is most questionable.

Credit competition and harmonization

Eximbank legislation required that it attempt to reduce credit competition among exporting nations. All major industrial countries offer some form of official credit support. Negotiations on a gentleman's agreement to reduce competition has been led by the Treasury Department for the United States, but no agreement has yet been reached.

Distinct from these negotiations, an agreement signed in October 1974, by the United States, France, Germany, Italy, Japan, and the United Kingdom provided in part that, as a general rule, export credit transactions of 3 years or more would not be officially supported among the signators nor with other wealthy countries. The Soviet Union is the second greatest economic power in the world, but it is treated under this agreement as an exception to the wealthy country rule. The language of Eximbank's bilateral agreement with the Soviet Union appears to commit the United States to provide terms no less favorable than those for similar transactions to other purchasers. Although Eximbank officials deny this is the case, the bilateral commitment could effectively deter the United States from entering into an agreement with other Western nations calling for a separate set of terms for Communist countries.

Reciprocal credits

In October 1972, the Soviets gave the United States assurances that credit facilities of the Soviet Foreign Trade Bank and foreign trade organizations would be made available to U.S. importers for the purchase of Soviet goods. This financing was to be no less favorable than financing available from U.S. Government or commercial sources for comparable export transactions. The amount of Eximbank credits to the Soviet Union is public information, but the Soviets have not published data on the amount and terms of credits extended to U.S. importers. No U.S. agency has compiled such information. Should the executive branch be successful in obtaining data on amounts and terms of credit granted by the Soviets, there would be a basis for judging the extent to which credits have been made available on a reciprocal basis.

Commodity Credit Corporation

The CCC finances commercial export sales of agricultural commodities from private stocks for a maximum of 3 years. The program was established in 1956 to meet competition from other foreign suppliers. Before enactment of the Trade Act, Communist countries eligible for CCC credits were Bulgaria, Czechoslovakia, Hungary, Poland, Romania, and the Soviet Union. The German Democratic Republic and the People's Republic of China are not restricted outright, but as a matter of policy CCC has not approved credits for exports to these countries. Poland and Romania are the only Communist countries currently eligible to receive CCC credits.

Various lines of credit have been extended to Communist countries under the CCC program; the most significant was the \$750 million extended to the Soviet Union in July 1972. Although this extension of credit required NAC approval, the agreement was not submitted to NAC until 2 days after it had been signed. The substantial U.S. agricultural exports to Poland, Romania, and the Soviet Union have coincided with the use of CCC credits. Since April 1973 interest rates for all countries have been raised to stay in line with commercial money market rates. Since then the Soviets have been reluctant to make use of the CCC Export Sales Program and have paid cash.

AGENCY COMMENTS AND OUR EVALUATION

The East-West Foreign Trade Board stated that the classified report appears to assume that Eximbank and other executive branch agencies intentionally gave preferential treatment to the Soviet Union, Poland, and Romania. The Board also commented that the report failed to bring out that Eximbank's (a) credit decisions were independent judgments in accordance

with its legislative mandate, (b) operating procedures were nonpreferential, (c) requirements for country economic information were applied consistently, and (d) participation did not displace private financing.

Eximbank's lack of written criteria for determining whether to approve or deny loans makes it difficult, if not impossible, to assert that the Soviet Union did or did not receive preferential treatment. Only Soviet loans were analyzed in our review. Whether or not Eximbank and other agencies acted intentionally, Eximbank's preliminary commitment procedures for the Soviet Union and Poland are unique in that only the respective Banks for Foreign Trade, not the U.S. exporter or U.S. commercial institutions representing the exporter, can apply for preliminary commitments.

Our report is concerned about the intent of Eximbank's legislative authority, which is that Eximbank be responsive to U.S. exporters. Eximbank has the right and, more importantly, the responsibility to ensure that agreements enable it to respond to U.S. exporters in financing and facilitating exports. Agreements made by other Western governments do not relieve Eximbank from fulfilling its legislative mandate.

We believe that Eximbank can and should provide U.S. suppliers with preliminary commitments. This, of course, would not change the fact that Soviet and Polish authorities would continue to control who wins contracts or is allowed to bid. However, we think a greater number of smaller U.S. companies would have a better chance to compete. As it now stands, control over Eximbank financing rests with Soviet and Polish authorities, and they have exercised this option of using Eximbank financing especially for larger projects of high priority. However, it is precisely on such projects that the essentiality of Eximbank financing is most questionable, since U.S. companies are the most likely to already have a competitive advantage over other Western suppliers.

Eximbank's basic purpose is to aid in financing and facilitating U.S. exports, by meeting competition and supplementing and encouraging, not competing with, private capital while ascertaining that its loans offer reasonable assurance of repayment. Although the Bank claims it makes independent decisions in accordance with its mandate, the lack of documentation and other evidence in its files makes this claim difficult to support. The report does not say that Eximbank made loans for political reasons but, rather, that if a particular loan is to be given for political reasons, there should be a determination

by the President that such financing is in the national interest and it should be approved by Congress.

Our report presents the facts that analyses of creditworthiness for the three nonmarket economies is more difficult because of the general lack of financial information. Also, the Soviet Union has not provided Eximbank with all the financial information requested. Receipt of this information is necessary if Eximbank is to apply the same standards to judging creditworthiness of the Soviet Union as it applies to other borrowers.

Our report does not overlook the limits--both legal and internal--on private sources of financing, but rather is concerned with the absence of information in Eximbank transaction files to document the essentiality of its financing. There are many indications that private commercial banks would be willing to participate in financing U.S. exports to nonmarket economies without Eximbank participation. The response ignores the basic point that the Soviets have paid cash when interest rates have risen. For example, the private Bank of America consortium raised \$250 million to finance U.S. exports to the Soviet Union, but the financing was not used, apparently because of the high interest rate prevailing at the time. Whether or not government supported credit is available from other Western sources, Eximbank is still responsible for independent determinations as to the essentiality of its financing. It should again be noted that, during the period in which Eximbank operations with the Soviet Union have been suspended, the Soviets have paid millions of dollars in cash to U.S. exporters for equipment. This implies that the availability of credit is not, in all cases, the key factor in Soviet purchasing decisions.

RECOMMENDATIONS 1/

For transactions involving Communist countries, the Chairman of Eximbank should:

- Renegotiate the basic Agreements on Financing Procedures between Eximbank and Soviet and Polish Banks for Foreign Trade to enable U.S. exporters and commercial institutions to apply for preliminary commitments.

1/These recommendations are based on the assumption that Eximbank facilities will again be made available to the Soviet Union, either through new legislation removing the link between emigration and Eximbank credits or through the Soviets' meeting the emigration requirements of the present legislation.

- Develop and apply more precise criteria for approving preliminary commitments.
- More rigorously analyze the appropriateness of Eximbank financing before preliminary commitments are issued.
- Better document (1) foreign competition, using U.S. commercial intelligence abroad, and (2) the willingness of private commercial banks to participate.
- Request that Eximbank and other executive branch officials refrain in their dealings with the Soviets and U.S. companies from giving assurances, however informal, that Eximbank participation in a given transaction would be forthcoming.
- Not authorize loans for other than economic reasons unless the President determines that such loans are in the national interest and Congress approves.

The Secretary of the Treasury should, as Chairman of the Joint U.S.-U.S.S.R. Commercial Commission, press the Soviet Union for information on (1) its international financial position so that Eximbank may determine creditworthiness over the long term and may apply the same standards to all borrowers, (2) the amounts and terms of credits it has granted to U.S. importers, so that there might be a basis for judging the extent to which credits have been made available on a reciprocal basis.

The Secretary should also seek to obtain the concurrence of other Western nations in treating the Soviet Union as a wealthy country in the context of the October 1974 agreement on harmonization of credit terms.

The Secretary of Commerce should advise U.S. importers that the Soviets have agreed to make credits available to them.

CHAPTER 4

ADMINISTRATION AND MONITORING OF EXPORTS TO AND EXCHANGES WITH COMMUNIST COUNTRIES

Detente has been described as an adversary relationship in which trade and technology provide economic incentives for the achievement of political goals. Export controls and technology exchanges provide a way to regulate and adjust economic incentives to these political aims. However, the executive branch lacks the technical capacity to regulate and adjust export controls and technology exchanges, for a variety of reasons largely unrelated to congressional activity.

GOVERNING LEGISLATION

The Mutual Defense Assistance Control Act of 1951, commonly known as the Battle Act, and the Export Administration Act of 1969, as amended, provide the legislative authority for controlling exports to and exchanges with Communist countries.

An international export control Coordinating Committee (COCOM) ^{1/} was created in 1949, without a basis in any treaty or international agreement, to effect a collective embargo on shipments of strategic goods to Communist countries. The Battle Act, originated in 1951 as a further cold war measure, was designed to extend the near embargo of the 1949 Export Control Act to a multilateral understanding with U.S. allies and aid recipients. The intent of the Battle Act is carried out through the international Coordinating Committee. COCOM lists and periodically reviews items which are mutually agreed to be of strategic significance and subject to export controls. Each COCOM country upholds the international control standard through its domestic statutory authority to control exports.

The Battle Act declared U.S. export policy to be an embargo on shipment of military items and commodities of strategic value to any nation or combination of nations threatening the security of the United States. Nonmilitary commodities not subject to Title I embargo were to be controlled by Title II. Title II commodities were not specified by the act and their selection was subject to the judgment of the act's administrator.

^{1/}Belgium, Canada, Denmark, France, the Federal Republic of Germany, Greece, Italy, Japan, Luxembourg, the Netherlands, Norway, Portugal, Turkey, the United Kingdom, and the United States.

The act authorized an Administrator and this function is exercised by the Secretary of State. Under Title I, he was charged with creating a list of items for embargo after full and complete consideration of the views of State, Defense, and Commerce and any other appropriate agency. Under Title II, the Administrator was charged with creating a list of commodities he believed should be controlled. He is under no responsibility to consult with other departments regarding Title II commodities. The Administrator is legally responsible for designating Title I and Title II commodities in a U.S. export control list to be negotiated with unspecified "aid recipient" countries in an international embargo. 1/

Although the system of COCCM multilateral export controls has been maintained since 1949, its operation has increasingly reflected the altered distribution of American influence in the world. Increased bilateral trade between individual COCOM countries and Communist countries has produced intense competition for Communist markets. The economic resurgence of Western Europe and Japan has further reduced U.S. influence on multilateral export control policies. Instead of the international lists reflecting U.S.-initiated controls as they once did, U.S. domestic export controls are now modified in accordance with reviews of international considerations.

The Export Administration Act of 1969, as amended, exists concurrently with the Battle Act. It directs the executive branch to encourage and promote trade by reducing export controls and to restrict exports of militarily significant goods and of technology detrimental to national security. Through the Export Administration Act, Congress also attempted to tie U.S. export controls to the multilaterally agreed COCOM export controls in order not to penalize American business interests. The act required a review of all U.S. multilaterally controlled items and directed the Secretary of Commerce to (1) remove those which were available elsewhere in comparable quality and significant quantity, (2) report to Congress on burdensome U.S. export control procedures, and (3) create Technical Advisory Committees consisting of industry representatives to advise Commerce on export control regulations.

1/Title II type commodities were abolished in 1958 and a new international category of nonembargoed but reportable transactions was established within COCOM. State's removal of commodities formerly listed under Title II rendered the penalty conditions of the Battle Act meaningless.

In the 1974 amendments to the Export Administration Act, Congress authorized the Secretary of Defense to review proposed exports of goods and technology and to report to the President, within 30 days, those he wishes to prohibit as significantly increasing the military capability of the recipient state. If the President authorizes the export, he must so notify Congress and inform it of the Secretary's recommendation.

Although Congress found that the U.S. defense posture was subject to serious compromise if goods and technology were exported without adequate review, it is doubtful that this provision provides it. The 30-day time limit and the required Presidential approval effectively reduce the scope of Defense review as only the most blatant, immediate, increased military capability caused by the export, rather than the longer range military significance, can be considered.

Formerly, national security export controls could be waived or selectively applied with minimum risk, because practically all trade with Communist countries was controlled to achieve diplomatic and commercial goals. Few controlled commodities actually had important strategic military significance. Today, the relatively few items remaining under strategic controls have a more direct military impact on the international distribution of power. Explicit national security considerations, rather than foreign policy expedients, are now pertinent considerations for the difficult distinctions necessary to apply export controls. Yet, since 1969, diplomatic initiatives rather than technical considerations have demanded continued relaxation of national security export controls.

EXPORT REGULATIONS

Commerce has licensing jurisdiction over all export commodities and unclassified technical data, except for certain specialized items under the jurisdiction of other Government agencies. 1/

Export licensing controls apply to (1) exports of commodities and technical data, (2) reexports of U.S.-originated commodities and technical data from one foreign country to another, (3) U.S.-originated parts and components used in a foreign country to manufacture a foreign end product for export, and (4) in some instances, the foreign-produced direct

1/For example, munitions control, Department of State; gold and foreign currency, Department of the Treasury; atomic materials and equipment, Nuclear Regulatory Commission.

product of U.S.-originated technical data. Controls extend to exports of U.S. subsidiaries, affiliates, or branches in foreign countries if the commodities are of U.S. manufacture, contain U.S. materials, and are based on restricted U.S. technology.

Exports must be authorized by either general or validated licenses. A general license permits the export of certain commodities and technical data without a license document for each transaction. A validated license authorizes the export of commodities within special limitations set forth in the license document which is issued only through formal application.

Most exports of manufactured products to Communist countries require validated export licenses. Applications for validated licenses to export controlled items to non-Communist countries are required primarily to insure against diversion to Communist countries.

Sweeping and significant regulations govern the export of technology. Access to technological know-how is often of greater strategic significance than is possession of the products of the technology. Thus, Commerce believes it necessary to exercise a significantly higher level of export control over technical data than over commodities. Effective regulation of technology exports is probably the most complex export control problem because of the difficulty of pinpointing areas of technology which should be controlled and establishing effective controls. Technology can be transferred in numerous and varied ways. It may be exported in the form of a prototype, a blueprint, or knowledge in a technician's mind. It may leave the country in the mind of a foreign visitor or as a package in the mail, a sales symposium held for prospective customers, or a result of foreign visitors viewing discrete engineering phases which collectively encompass an entire technology process.

Office of Export Administration

Commerce's Office of Export Administration (OEA) is responsible for administering and enforcing the export control regulations and programs required by the Export Administration Act. OEA also chairs the interagency Operating Committee of Commerce's Advisory Committee on Export Policy.

OEA currently has 141 permanent employees and 7 operating divisions, one of which deals with short-supply export controls.

The Scientific and Electronic Equipment Division and the Capital Goods and Production Materials Division handle,

among other commodities, computers, computer peripherals, semiconductors, and the technological interrelationship to telecommunications equipment and numerically controlled machine tools. Confusion and policy differences exist between these divisions over jurisdiction and implementation of regulations and over what should be exported in each of the above commodities.

The Technical Data Division is unable to effectively enforce technology export controls. The Policy Planning Division develops export control policies for specific commodities and countries, but much of its work is devoted to resolving interagency differences on a case-by-case basis. The Compliance Division is unable to effectively determine compliance with export control regulations and has limitations on its ability to investigate alleged violations. The Operations Division is responsible for issuing export licenses, but its operations for screening applications need substantial improvement.

There are other important shortcomings and limitations on OEA's effectiveness. Personnel levels have been greatly reduced by attrition since 1971 despite the increased responsibilities of the office and OEA presently has too few professionals to review the increasingly complex technical parameters on permissible exports to Communist countries. Reductions in export controls have not been accompanied by reduced administrative functions.

OEA depends upon Department of State personnel to perform all OEA-initiated compliance activities overseas. State, however, has consciously reduced its designated export control staff positions and COCOM-related compliance activities overseas. Although U.S. strategic controls are based on maintaining a military technology gap with Communist countries, the absence of effective commodity and technology export controls undermines this policy.

Office of East-West Trade

State's export control functions are centered in the Office of East-West Trade of the Bureau of Economic and Business Affairs.

State asserts the primacy of foreign relations as its claim for preeminence in export control matters. Diplomatic considerations--acceptability of U.S. positions to COCOM partners and how U.S. influence in Communist countries can be multiplied through COCOM export controls--dominate its thinking on export controls. There is little regard for complex technical issues.

The office of East-West Trade's functions have expanded from responsibility for export controls only to all commercial policy questions for Communist countries. Personnel allocations have reflected this change in emphasis. State has greatly curtailed export control work as conflicting with detente and has eliminated staff positions concerned with overseas compliance and control activities. Export control activities are organized in two working groups, a compliance unit and a COCOM unit.

The compliance unit has become primarily a screening mechanism, and in its present capacity can effectively restrict compliance activities in deference to diplomatic considerations. The compliance unit does not initiate compliance requests. Only Commerce initiates compliance requests for pre- and post-licensing checks abroad, and these are reviewed by the compliance unit and area desks prior to transmittal to State personnel overseas. Commerce's requests would be more clearly formulated and better understood if they were deliberated by interagency committees rather than being reviewed by the Office of East-West Trade alone.

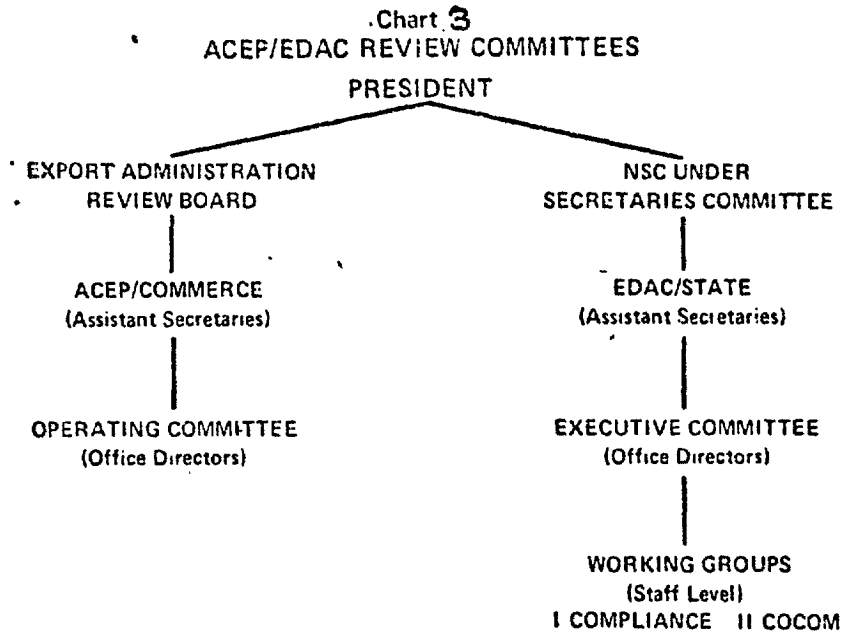
Under the Battle Act, failure by COCOM partners to provide information necessary to evaluate other COCOM country compliance efforts is grounds for suspending U.S. assistance. State either has not received adequate compliance information from other COCOM members or is embarrassed by the results, as they refused us access to such information.

The activities of the COCOM unit dominate the work of the office, providing the structural conduit for transmitting State's foreign policy considerations from COCOM to the U.S. interagency domestic export control committee chaired by Commerce and the State-chaired interagency multilateral export control committee. To represent the State Department's foreign policy and diplomatic considerations in interagency decisionmaking and to explain and reflect these decisions in COCOM, the Office of East-West Trade needs the capacity to appreciate the technical issues as they relate or are claimed to relate to national security. The office does not appear to have been nearly as effective in transmitting decisions and considerations to COCOM countries as it has been in transmitting such matters to the interagency control committees.

Export Control Interdepartmental Coordinating Committees

Two interdepartmental committees coordinate export control policy, the Advisory Committee on Export Policy (ACEP) and the Economic Defense Advisory Committee (EDAC). ACEP is chaired by Commerce and creates and administers U.S.

export controls. EDAC is chaired by State and coordinates and conducts U.S. participation in COCOM. The work of the committees involves deciding what items will be on their respective commodity control lists and whether exception requests to export these listed items should be approved.



Source: Prepared By GAO From Information Provided By Commerce and State

ACEP

This committee was formed to assist the Secretary of Commerce in creating and administering the U.S. Commodity Control list. It is chaired by the Assistant Secretary of Commerce for Domestic and International Business and consists of counterpart representatives from Defense, State, Treasury, the Nuclear Regulatory Commission, and the Central Intelligence Agency. The latter participates in ACEP principally to provide analyses of Communist technological capabilities and requirements as well as intelligence on diversions.

The Assistant Secretary level of ACEP almost never meets. Its work is carried out by an Operating Committee, chaired by OSA's Assistant Director of Policy Planning. If Operating

Committee members cannot agree on a decision, the case is referred first to the Assistant Secretary level of ACEP, then to the Under Secretary level of the Export Administration Review Board of Commerce, Defense, and State. Continued departmental disagreements require Presidential decisions and have occurred frequently in the past.

ACEP follows a unanimity rule and appeals cases of interdepartmental disagreements to higher policy levels for resolution. It reviews export licenses of other COCOM country-controlled exports which contain U.S. components subject to U.S. validated export licenses. Cases are placed on the Operating Committee's agenda strictly in order of submission. About 40 cases are usually on the agenda. The Committee meets no more than once a week and can handle about 10 cases at each meeting if there are no questions or requests for further analysis.

ACEP procedures for reviewing exception requests for U.S. export controls encourage delays and reflect the absence of interagency consensus on many cases. ACEP's unanimity rule for approving exception cases can create a consensus only on the particulars of the case reviewed. Without a rule of precedent, the unanimity rule represents a multiple veto and is a substitute for consensus on export controls within the executive branch. Such procedures are made even more time consuming by the strict and unwavering disposition of agenda items in the order submitted.

Exception requests are provided to all COCOM delegations with the understanding that they will respond within 18 days. U.S. delinquency in responding to other COCOM members' exception requests is a serious problem. U.S. COCOM representatives have repeatedly expressed their embarrassment to the Department of State and foreign representatives at this country's status as the largest petitioner for COCOM exceptions and the slowest respondent to others' requests. The overwhelming proportion of pending cases are awaiting U.S. action. Foreign COCOM representatives have alleged bad faith in these deliberations. Some State Department officials suspect that Defense Department delays encourage the appearance of the United States as disposed toward interminable delay in dealing with COCOM exception requests while promoting U.S. projects. Such an attitude on the part of other COCOM members could foster defiance of multilateral export control objectives and encourage Defense's demands for separate U.S. controls.

EDAC

This interagency committee consists of representatives of State, Defense, Commerce, Treasury, the Nuclear Regulatory Commission, and the Central Intelligence Agency. The Central Intelligence Agency performs the same role in EDAC as it does in ACEP. EDAC is chaired by the Assistant Secretary of State for Economic and Business Affairs.

The work of EDAC is conducted by Working Group I, a lower level interagency committee involving the same departments. An executive committee chaired by the Director of the Office of East-West Trade guides Working Group I and reviews its proposals. If the working group cannot reach unanimous agreement on a case, the matter is referred to the executive committee and then to a meeting of EDAC principals. If the principals cannot agree, the issue is forwarded to the National Security Council's Under Secretaries Committee in preparation for a Presidential determination. This has happened on several occasions.

The head of the COCOM unit chairs the interdepartmental working group. He and his staff coordinate the U.S. inputs to the periodic COCOM country list reviews and U.S. departmental positions on COCOM country exception requests. COCOM list reviews are conducted every 2 or 3 years. Working Group I is assisted in this process by Technical Task Groups which consider the technical parameters of specific commodity categories. These advisory groups consist of commodity specialists and are formed on an ad hoc basis. They usually are made up of Government technical experts as well as consultants from the private sector.

EDAC considers exception requests submitted by other COCOM countries. If a U.S. license is needed because the export contains U.S.-controlled components, the exception request is also considered by ACEP. EDAC usually will not consider the case until after ACEP has ruled on the U.S. license application. Most significant COCOM exception cases require U.S. licenses, because of their U.S.-controlled components. In these so-called dual-licensing cases, both ACEP and EDAC consider substantially the same factors. Thus, once ACEP has approved the U.S. license, EDAC should have little choice but to affirm the decision or to delay it. However, ACEP and EDAC have not always agreed in these dual-licensing cases. In some cases, the U.S.-controlled component is licensed, but the COCOM country exception request is denied by EDAC.

EDAC procedures permit staff level opposition to be expressed without formal departmental objections being raised. In the absence of departmental objections, foreign exception requests are approved despite staff opposition. These procedures prevent operating levels from tying up interagency reviews without the support of their superiors. Foreign exceptions are approved by EDAC in many cases, not because operating levels are in agreement, but because agency specialists don't think their policy levels will support them.

The emphasis on multilateral export controls has marked a shift in U.S. policy and enhanced the influence of diplomatic considerations in reviews of U.S. export controls. By emphasizing foreign policy issues as decisive, State limits the ability of more technically competent agencies to influence interagency reviews of export controls and exception requests as they affect national security.

Two separate interagency review committees are not necessary. Foreign exception cases generally represent the standard of acceptable sales for international business competition. The United States cannot consistently oppose these cases without endangering the preservation of multilateral export controls. Judicious use of U.S. objections to other COCOM country exception requests is necessary to maintain the added effectiveness of multilateral controls. A separate EDAC structure is not needed for this.

U.S. export controls are still more extensive than COCOM controls because of end use, reexport, and component-licensing requirements. They are based on regulations designed for national security rather than foreign policy considerations. Thus, the controls should not be lightly altered for diplomatic expediency. An expanded ACEP review system, established and operated under existing EDAC objection procedures, could be responsive to foreign exception cases within COCOM time limits and to U.S. exception cases. The expanded ACEP system could more accurately determine national security implications of all exception requests.

TECHNOLOGY EXCHANGES

Technology transfers are difficult to monitor and control. The difficulties are multiplied by the diverse purposes of Government and private exchange structures. The impact of technology transfers on Communist societies and on the maintenance of a military technology gap are unanswered questions. Suspicions exist in both Government and business that the levers of export control and technology exchanges are being ineptly managed to achieve temporary policy objectives. Although technology exchanges have been

a key element in U.S. foreign policy, industry officials believe the exchanges are hampered because the Government is poorly organized to promote and control them.

Foreign policy considerations dominate the entire structure of technology exchanges with Communist countries. Technical problems--degree of reciprocity, impact of transfer, monitoring and coordinating transfers in compliance with export controls, private technology exchange protocols, inadvertent or indirect transfers and marketing implications--are largely ignored.

The present review structure for technology exchanges cannot cope with the technical problems presented. The adequacy of this structure can only be justified by the claims that no significant technology exchanges have occurred under the public agreements and that no one can control transfers that may occur through private sector agreements and exchanges.

Government-to-government

The United States and the Soviet Union have entered into 11 scientific and technical cooperation agreements as a result of the May 1972 Agreement on Cooperation in the Fields of Science and Technology. All agreements are under the coordination of the Office of Soviet and Eastern Europe Scientific and Technological Programs of the Department of State. Private industry is represented in the U.S. membership of all joint committees which administer the agreements. Executive agencies participate in these agreements under broad policy guidelines which emphasize genuine reciprocity in the technical exchange of each program, but there is little actual mutual benefit on this basis.

It is difficult to categorize the technical benefits which accrue from these agreements. According to State, little technology has flowed in either direction, and the major benefits are political.

Each of the agreements is covered by a provision that U.S. technical exchanges are subject to U.S. laws and regulations. Agreements for export of technology are covered by provisions of the Export Administration Act, which requires validated export licenses for all technical data generally related to detailed design, production, or manufacture of controlled commodities. The technology to be transferred is examined by the U.S. agency primarily responsible for the joint project and Commerce's Office of Export Administration is asked for advisory opinions on all projects undertaken within an agreement. OEA has never denied a proposed technology transfer under the agreements. It indicated that it could not

second-guess the expertise of the joint committees. The Director of OEA's Technical Data Division felt that such technology was covered by an exemption to export controls for educational material and that sufficient protection against improper transfer was provided by informing all U.S. Executive Secretaries of Joint Commissions that their decisions must be in accord with export control regulations.

Private sector-to-government

U.S. private sector agreements are justified under the Agreement on Cooperation in the Fields of Science and Technology and usually consist of an agreement for scientific and technical cooperation between a U.S. firm and Soviet agencies.

These agreements, or protocols, are distinct from the more numerous contractual agreements for technology transfers for specific projects. They are normally general in nature and are described by many State and Commerce officials as merely agreements to agree. The agreements provide for a continuing exchange of technical information and specialists and direct project-oriented cooperation in a variety of specified areas and they reflect a broad spectrum of U.S. industrial capabilities.

Commerce Department proposals to require the submission of these protocols to the Government for review within 15 days of signature have been vigorously opposed by exporters and no reporting requirement presently exists. The U.S.-Soviet covering agreement does not provide for review or approval of technical cooperation protocols by the Joint Commission established to monitor the agreements. Thus, there is no assurance that U.S. Government information on the number and content of these protocols is complete. Normally, the Government would be unaware of such agreements unless a firm had reason to consult with either Commerce or State.

The Soviets use private protocols to further expand government-to-government agreements and to gain access to modern U.S. commercial technology. This expanded access also increases chances of inadvertent or unauthorized transfer of technology. Regulating technology transfers is exceedingly difficult because of the variety of ways in which technology may be exchanged. Most important is industry's initiative in defining the critical export control variables which determine whether nonpublic or noneducational technical data require validated export licenses from Commerce.

The increased exposure of the Soviets to U.S. technology provided under the protocols makes the enforcement of controls totally dependent on industry cooperation. The operating assumption of OEA that proprietary information would be sold rather than given away was considered naive by intelligence analysts and conflicts with major examples of contrary company behavior. Many analysts believed the Government should oppose the provision of technology by private firms except by country-to-country commercial agreement. These analysts fear that public policy statements and trade promotion efforts have fostered an incorrect understanding on the part of business over how far the United States is prepared to move.

Regular commercial contracts

Technology for design, production, or manufacture of a commodity is often transferred directly or indirectly by commercial contracts. Such transfers are the most common form of technology transfer and are subject to Commerce licensing approval. These licenses cover the range of U.S.-originated technology exported from either non-U.S. or U.S. sources. Between October 1971 and October 1973, 372 contracts were authorized with Communist countries and only 7 were denied. Commerce has not released more current information.

Commerce explained that there was no relationship between the number of contracts authorized to export technology and the number of transactions actually consummated, because proposals for technology sales are significantly more numerous than acceptances. On the other hand, the technology necessary for preparing sales offers is exempt from export control regulation and, therefore, not reflected in the number of licenses issued. There is also the possibility of widespread technology transfer through corporate licensing practices and marketing arrangements with overseas corporations which are not subject to licensing approval.

AGENCY COMMENTS AND OUR EVALUATION

The East-West Foreign Trade Board stated that the classified report identified some of the more difficult issues associated with effective management of current national and international systems of export controls but was less successful in formulating procedural recommendations to improve current operating procedures. Specifically, the Board felt that Commerce should not be relieved of the licensing and monitoring of technology because such licensing was an integral part of Commerce's overall licensing efforts.

We did not recommend that Commerce be relieved of such duties. Because of significant limitations on its effectiveness, we recommended that the Technical Data Division be disbanded and that the East-West Foreign Trade Board determine the most suitable agency for handling this function; taking into account the importance of technology transfers on national security and the domestic economy.

The Board also felt that our recommendation that the Operating Committee of ACEP follow a majority rather than unanimity rule would distort the purpose of the Committee and detract from its utility.

We see little merit in having a unanimity rule for a committee whose charter ostensibly is to secure advice and recommendations for Commerce from advisory agencies. If this were truly the case there would be no reason to have unanimous consent on any case, merely the various recommendations offered. A majority of the voting participants would suffice to provide the desired advice and recommendations.

MATTERS FOR CONSIDERATION OF CONGRESS

In the light of the conflicting purposes addressed by successive amendments to the Export Administration Act since 1969, Congress should examine the issue of export controls and technology exchanges to establish the (1) criteria and standards presently being applied and their implications for detente policies and national security, (2) relationship of technology transfers to strategic controls and current business practices, and (3) decisionmaking responsibility in present interdepartmental export coordinating committees.

RECOMMENDATIONS

Regardless of the need for congressional examination to crystallize the nature, extent, and implementation of U.S. export control policy, the executive branch organizational structure must continue to operate in some form because of U.S. commitments to existing domestic statutes and international organizations. The following recommendations, therefore, are intended to improve the organization of executive branch agencies responsible for carrying out such activities. Our recommendations for improving operating procedures of these agencies are contained in chapter 5.

We recommend that the Secretary of Commerce strengthen Commerce's role in upholding and licensing national security controlled commodity exports as the agency most responsive to congressional concerns, as follows.

1. Provide additional personnel resources for and improve the operation of the Office of Export Administration.
2. Remove responsibility for monitoring and licensing technology transfers from the office by disbanding the Technical Data Division and requesting the East-West Foreign Trade Board to determine the most suitable agency for handling this function. (See recommendations 2 and 3 to the Secretary of the Treasury, p. 41.)
3. Upgrade the Advisory Committee on Export Policy's Operating Committee by elevating its role in the Office of Export Administration with an expanded technical staff and require its work program to conform to COCOM approval time frames and employ majority rather than unanimity rule decisionmaking.
4. Require that public lists or some suitable disclosure be made of validated export licenses granted by OEA, including commodity designations, size parameters, and country of destination.
5. Improve the system for screening license applications by adding additional computerized data bases.

We recommend that the Secretary of State alter State's role in export controls to conform with a lead role concept for the Department of Commerce and expand State's monitoring role in technology exchanges, as follows.

1. Discontinue the Economic Defense Advisory Committee review structure for COCOM exception cases and cooperate with Commerce in incorporating its responsibilities in ACEP under Commerce chairmanship.
2. Reexamine the Office of East-West Trade's compliance responsibilities to determine the most efficient coordination of State's minimum compliance role overseas.
3. Insure that guidelines for the COCOM working group in the Office of East-West Trade direct the group to concern itself exclusively with representing interdepartmental ACEP accord in all COCOM deliberations and to be solely responsible for representing State in all ACEP deliberations.
4. Direct the Office of East-West Trade to avail itself of the technical expertise offered by other State bureaus in order to effectively participate in

ACEP and COCOM deliberations on the national security implications of strategic controls and technology transfers.

5. Reevaluate and upgrade the administrative structure of the U.S.-U.S.S.R. exchange agreements, with increased emphasis on (a) reviewing technical exchanges from the perspective of technology transfers, including private sector exchanges and transfers, and (b) identifying U.S. items in the exchange which are subject to termination by U.S. Government action and Soviet items which are most important to the United States.

We recommend that the Secretary of the Treasury, as Chairman of the East-West Foreign Trade Board:

1. Direct the Council on International Economic Policy to initiate a comprehensive study of technology transfers and their impacts on national security and domestic economy.
2. Determine the organizational requirements and objectives in monitoring international transfers of technology to and from the United States, characteristics of these transfers which should be monitored, and methods which could be used in concert with the CIEP study.
3. Designate the agencies to be responsible for these objectives through implementing all or part of the monitoring program.
4. Designate scientific and technological transfers as a key intelligence question for Central Intelligence Agency reporting.

CHAPTER 5

PROBLEMS OF IMPLEMENTING EXPORT

CONTROLS AND TECHNOLOGY EXCHANGES

WITH COMMUNIST COUNTRIES

U.S. efforts to monitor exports and to implement commodity controls in East-West trade have raised diverse and conflicting executive department points of view concerning appropriate regulations. They have also demonstrated profound international differences between the United States and other COCOM members over the use of international controls. These differences create important policy questions that are subject to conflicting executive department views.

U.S. efforts to monitor and to implement international technology exchanges in East-West trade are plagued by many of the same types of problems faced in controlling commodity exports. The concept of reciprocity is espoused as the basis for administering these exchanges. However, technology exchanges raise such basic questions as: What is being exchanged for what purposes? Has satisfactory reciprocal performance occurred? What procedures have been established to review and redress asymmetrical benefits accruing under the exchanges? All these questions, as well as massive implications for the domestic economy, are raised by the U.S.-U.S.S.R. Agricultural Cooperation Agreement entered into in June 1973.

INTERDEPARTMENTAL DIFFERENCES

There is no basic interagency agreement on criteria for export controls and on whether foreign policy, commercial, or defense considerations should dominate trade policy with Communist states. Executive branch agencies have fundamental differences regarding licensing standards and procedures to be followed in administering controls. Agency reactions appear to result from the priority of their concerns and the nature of their constituencies.

Executive branch agency disagreements over export control review and operating procedures are caused essentially by a lack of substantive agreement on detente. Defense's Office of Strategic Trade wants a voice in every control decision. Defense is reluctant to relinquish or delegate any authority to Commerce's Office of Export Administration because it believes that office does not have the technical capability to insure that licensing restrictions are properly applied. Commerce has conflicting priorities and coordination problems. Its Bureau of East-West Trade cooperates closely with State in promoting trade with

Communist countries, but OEA, part of the Bureau, shares many of the concerns of Defense and has coordination problems with Commerce's Office of International Marketing. State's export officials in the field have different perceptions than those in Washington concerning the effectiveness and importance of export controls, cooperation of COCOM countries in adhering to multilateral controls, and the effect of various COCOM country practices on foreign business competition. Thus, the liberalization of export controls has been both a planned consequence of policy decisions and an unplanned consequence of differing departmental views, practices, conflicts, and reactions to foreign actions.

Differing departmental priorities have resulted in a continuous series of ad hoc decisions and fragmented consideration of strategic export controls. The problems of identifying and implementing an interdepartmental and multilateral consensus on export controls are seen in three types of licensing procedures: (1) third-country reexport of U.S.-controlled items, (2) ultimate consignee end-use information requirements, and (3) temporary validated export licenses. State and Commerce believe U.S. procedures are too stringent and burdensome for their negligible contributions to national security. Opponents of this view in Defense, OEA, and the Nuclear Regulatory Commission have little confidence that national security constraints on U.S. exports can be adequately maintained without these additional licensing procedures.

Third-country reexports

The aims of direct U.S. export controls with Communist states are frustrated by (1) reexport of American strategic goods by non-Communist countries, (2) incorporation of U.S.-origin components in foreign strategic products for direct exports to Communist countries, and (3) exports of foreign strategic products to Communist countries which were derived from U.S.-origin technical data. Such reexports are the reason the United States requires the licensing of components in COCOM-controlled commodities and ultimate consignee end-use information for U.S. exports. U.S. licensing requirements for U.S. components or technology is the only way of its participating in COCOM country high-technology export decisions.

Nevertheless, there is little actual control over the reexport of American components or technology once it enters a foreign country, regardless of U.S. licensing requirements. Foreign customs services evidently lack the expertise to recognize evaluations of approved technical specifications and lack familiarity with American export controls governing reexport.

The reexport of U.S.-controlled commodities without U.S. approval is the most significant form of illegal diversion to Communist states.

The consensus among executive branch agencies indicates that they believe the only meaningful export control safeguard is the initial decision to allow a U.S. export. In other words, if one wants to really control an item, don't permit it to be exported.

Ultimate consignee end-use information

All COCOM countries require information on the end use, user, and destination of all embargoed commodities approved as exceptions, but these vary widely. Most other COCOM countries require only assurances by the seller as to the buyer's end use. Ultimate consignee end-use information is the backbone of United States legal enforcement of its export control laws. The primary value of this information is to deter foreign reexporting. COCOM countries generally do not verify the end use or the quantitative restrictions contained in almost every exception request granted. Postshipment verifications are not requested because they are diplomatically sensitive, administratively costly, and meaningless without trained personnel to do the verification.

One means used to verify the end use of equipment is to require the selling company to verify end use as part of its servicing of contracts. However, there are dangers in this because the sellers have service and training programs for host-country nationals as part of their marketing efforts. Foreign nationals could and do perform U.S. end use checks. In such cases, they could be viewed by their own governments as foreign agents, should they discover misuse and report it, or by their employers as potential counterintelligence agents, should they fail to do so and falsify company reports. Thus, there is no assurance of independence in this end-use verification procedure.

Temporary export licenses

Temporary licenses are issued to permit the display of commodities which otherwise would require validated licenses to export. These licenses enable controlled commodities to be displayed as part of Government-sponsored trade exhibitions in Communist countries. Issuance of temporary export licenses has created problems. Advisory Committee on Export Policy representatives have been pressured for rapid approval of temporary licenses to permit controlled commodities to be part of trade promotional efforts. OEA does not verify that commodities cleared by participation agreements are

actually displayed. A Commerce trade show report was critical of the ease with which companies could display and possibly sell commodities overseas which were not approved for display.

Commerce technical advisory committees

Technical advisory committees have been created by Commerce for seven high-technology areas for which U.S. export controls are the most burdensome. The committees were created under authority of the Export Administration Act to provide greater industry access and advice to the Government's decisionmaking structure of export controls. Questions concerning the role of technical advisory committees are both substantive and procedural.

Many companies serving on advisory export control committees have strongly opposed Commerce's proposal for disclosure of technical protocols between private industry and Communist governments. Many of the same companies represented on Joint Committees have also entered into private scientific and technological cooperation protocol agreements with the Soviet Union in the same research areas. Commerce has not required such disclosures from companies represented on its technical advisory committees because it claims that company officials on these committees sit as public-spirited technical advisers rather than as representatives of private interests. This claim is not supported by either the personnel selection process or the products the committees reviewed for modification of export control procedures.

Priority of interdepartmental concerns and erosion of controls

The policies of detente and trade promotion have attempted to reduce the impact of export controls on the flow of commerce between the United States and Communist countries. Not all the erosion of control standards has been a result of deliberate policy judgments, and interdepartmental differences have accentuated the discrepancies and conflicts in U.S. and COCOM country export control objectives.

Interdepartmental delays in U.S. approval of COCOM country exception requests have resulted in foreign ultimatums to approve the request or to accept the foreign country's withdrawal from COCOM. In each case we noted the United States approved the exception request without reviewing the corporate licensing practices and the technology control policies which transferred the U.S.-controlled technology to the COCOM country in the first place. The United States attempts to maintain a technology gap with Communist countries by using export

controls while also permitting U.S. business to compete for sales in these countries with products available elsewhere. The consequences of these dual efforts on unilateral and multilateral export controls cannot be understood within the Government without reviewing corporate licensing practices which transfer U.S. technology to COCOM countries and COCOM country compliance with existing control procedures. Neither review has been performed.

Commerce, OEA, and ACEP procedures are slow and awkward and needlessly dependent on unaccountable practices, unanimity rules, limited OEA discretion, arbitrary agendas, and unlimited discussion of exception requests.

Defense wants to examine the military potential of each exception request. This examination is heavily dependent upon highly subjective appraisals of the potential exports' possible impact on Communist military and economic capabilities. Underlying assumptions contained in these appraisals are seldom critically examined. Defense insists on postshipment safeguards which are neither effective nor feasible as conditions for approving such exceptions.

State officials we discussed these matters with believed the strategic control issues raised by other executive agencies in present and foreseeable trade with Communist states were designed to retain agency influence in interagency policy reviews rather than to respond to legitimate security concerns. These officials considered that most national security controls were adjuncts to foreign policy implementation rather than national security policy. In line with this belief, American Embassies have played an active role in promoting projects involving U.S.-controlled commodities and technology. Accordingly, export control functions in U.S. Embassies have been downgraded through elimination of export control positions and failure to perform end-use verifications.

INTERNATIONAL DIFFERENCES

Many U.S. officials familiar with export controls have little confidence in COCOM as a strategic control mechanism. They believe the United States must rely on its own export control regulations as additional safeguards. U.S. Embassy officials contacted have little confidence in the willingness of other COCOM nations to uphold multilateral security controls in the pursuit of trade. Competition for bilateral trade with Communist countries among COCOM countries has intensified with detente policies while the multilateral consensus on export controls has constricted.

Strategic controls and
commercial competition

U.S. behavior in COCOM has fostered other member countries' suspicions of its motives and objectives. The United States has been accused of pursuing commercial objectives and attempting to eliminate foreign competition through its use of exception approvals to national security export controls. Frequently, the appearance of commercial advantage reduces U.S. ability to influence export control decisions based on policy grounds. Delays in U.S. decisions on foreign exceptions caused by obscure departmental differences and efforts to conceal the real basis for U.S. policy considerations exaggerate these COCOM country suspicions.

The United States has requested COCOM exceptions to export high-technology items to Communist states while opposing comparable but less sophisticated items proposed for export to the same countries by other COCOM members. U.S. representatives to COCOM have attempted to distinguish between these COCOM-approved U.S. exports and U.S. disapproval of COCOM exports on the basis of similar end-use assurances.

The United States has also:

- Proposed COCOM administrative exception standards for computers exported to the People's Republic of China which fell most heavily on the small and medium sized machines manufactured by its COCOM partners.
- Informally assured another COCOM member of only proforma objections to the proposed sale of military items to a Communist country, despite a study concluding such approval would erode the last significant barrier controlling COCOM exports--military end-use. (This sale reportedly was consummated in December 1975.)
- Systematically dismantled its overseas export control compliance capability and simultaneously failed to press for uniform, minimum multilateral compliance requirements and standards. (This suggests that the United States is not seriously concerned about enforcing present export control standards.)
- Been tardy in considering COCOM exception requests while promoting the sale of similar commodities in the same Communist countries, through high-level trade missions and shows, and requesting emergency COCOM approval.

... AVAILABLE

On the other hand, Communist trading practices have severely tested the efficacy of multilateral controls by offering premiums for delivery of embargoed goods, soliciting large purchases from highly competitive companies conditional on delivery of financially insignificant controlled products, and encouraging the belief that COCOM controls are ineffective.

Implementing the Agricultural Agreement

The many problems of exchanging data, controlling transfers, and establishing reciprocity in scientific and technical cooperation agreements are manifested in the U.S.-U.S.S.R. Agricultural Cooperation Agreement signed June 19, 1973. This agreement amplifies the broader principles and aims of agriculture exchanges agreed to during the President's visit to the Soviet Union in 1972. It is also the most commercially significant of the joint exchange agreements, and its administration typifies the difficult tradeoffs among competing national economic and diplomatic interests inherent in all the exchange agreements. It also reflects the inertia such agreements acquire, becoming forces or major policy considerations with their own specialized bureaucracies and procedures.

The regular exchange of forward estimates of production, consumption, demand, and trade of major agricultural commodities is called for by Article II, paragraph 1 of the Agreement. The Soviet provision of forward estimates continues to be a major contentious issue as they have not implemented the terms of the article. This data is critical in controlling U.S. wheat and corn exports so as to minimize domestic disruption in food prices and to insure domestic availability.

Two primary questions for U.S. policymakers are raised by the Agricultural Agreement. Has the Soviet refusal to provide the previously agreed-upon information been a result of inadequate U.S. pressure? Have the other benefits the United States derives from the research and technology portion of the agreement been sufficient to overlook Soviet failure to provide forward estimates?

The United States has been unsuccessful in monitoring and administering most technology exchange agreements, not only from the standpoint of export controls but also from the perspective of reciprocity. In the case of the Agricultural Agreement, the Department of Agriculture has not achieved its primary objective of obtaining forward estimates data.

The central remaining issue of the Agricultural Agreement is whether partial compliance by the Soviet Union offers sufficient benefits for continued U.S. compliance. The executive branch has not explicitly made this judgment nor fully examined the options for coping with this partial Soviet compliance.

MATTERS FOR CONSIDERATION OF CONGRESS

A series of interrelated questions concerning the operation of multilateral and unilateral export controls need to be answered. How are unilateral and multilateral controls interrelated in export control decisionmaking? What is the nature of information and enforcement requirements for this process? How are these decisions related to U.S. foreign policy and national security requirements? The United States cannot afford case-by-case application of export controls without first determining its overall goals and objectives and the means to measure their achievement.

These matters should be developed in conjunction with a comprehensive multiagency review of export controls involving both the legislative and executive branches of Government. We stated previously that Congress should examine export controls and technology exchanges. In the context of such an examination, Congress should seek to answer the above questions on export controls. To consider national policy goals and formulation or possible changes in governing legislation, Congress should also develop information on the following matters.

1. Formulation of executive branch goals and objectives for export controls and their role in national security policy and foreign policy.
2. Relationship between the interdepartmental decision-making process for export controls and the achievement of executive branch goals and objectives.
3. Relationship between U.S. unilateral control decision-making and COCOM country compliance measures.
4. Responsibilities of private interests in the policy formulation and implementation process and Government information requirements.
5. Nature of industry contributions needed for export control policy and licensing decisions to be used as a basis for congressionally determined criteria for membership selection and responsibilities of the technical advisory committees.

RECOMMENDATIONS

Pending the outcome of a legislative and executive branch review of export controls, the Secretary of Commerce should seek to strengthen Commerce's preeminence as the agency primarily responsible to Congress for implementing and enforcing commodity export controls. Specifically, we recommend that:

1. OEA be directed to
 - a. create an overseas export control verification and enforcement capability,
 - b. reexamine licensing procedures and ACEP procedures to facilitate review of exception cases within COCOM time frames, and
 - c. undertake a study of the export control implications of abandoning postshipment safeguards in considering decisions to license exports.
2. OEA discretion be expanded in issuing validated export licenses for commodities covered by COCOM administrative exception categories without requiring interagency review.
3. ACEP be directed to prepare an interdepartmental planning document on the relationship of present U.S. technology transfers to unilateral actions contrary to COCOM export controls and on the range of related possible U.S. responses to COCOM-country threats of unilateral action.

The Secretary of Defense should reconsider Defense's responsibilities in formulating and reviewing export controls, emphasizing the development of explicit national security criteria to indicate the types of cases it wishes to review. We recommend that the:

1. Scope of Defense deliberations on export controls be reduced to priority cases. The current narrow technical criteria should be broadened to probable rather than possible military uses and detrimental effects on U.S. security.
2. Office of Strategic Trade either narrowly redefine its review responsibilities under the suggested priorities or acquire sufficient staff to exercise its reviews promptly.

The Secretary of State should reconsider the foreign policy ramifications of decisions affecting the continuance of COCOM and the participation of its membership. U.S. interagency positions on major COCOM exception cases should be consistent with positions on U.S. cases and supported by foreign policy decisions. The necessity and value of a multilateral consensus should be carefully weighed against U.S. national security interests in export controls. We recommend that the Secretary:

1. Request a departmental study of the (a) effects of detente on bilateral COCOM country trade with Communist states, and (b) relationship between COCOM bilateral trade changes and national export control compliance efforts and their effects on a viable COCOM consensus.
2. Attempt to establish an agreed-upon COCOM minimum compliance standard for multilateral export controls as the incentive for the United States to review dual licensing procedures.

BEST DOCUMENT AVAILABLE

CHAPTER 6BALANCE OF DIPLOMATIC AND COMMERCIAL BENEFITS

In the U.S. strategy to improve relations with Communist countries, trade liberalization was seen as an incentive for improved cooperation in political and strategic relations. Although such general diplomatic objectives are frequently cited as justification for U.S. trade initiatives, there is no evidence of any effort to use trade to obtain specific diplomatic concessions. In fact, there is a lack of precision and consensus on what U.S. diplomatic objectives are, whether they have been or are being achieved, or what they would be worth if forthcoming.

Furthermore, the United States has not achieved a genuine normalization of commercial relations because of the failure to effectively respond to the imbalance of bargaining leverage enjoyed by the nonmarket economies. This imbalance limits the negotiating leverage of U.S. firms and compromises the U.S. Government's ability to support commercial interests or to protect broad national interests.

DIPLOMATIC BENEFITS

U.S.-Soviet relations are the major focus of this chapter. The U.S. objective of promoting trade as a means of moderating Soviet diplomatic behavior has appeared frequently in executive branch statements and policy studies. This interrelationship has frequently been cited in testimony by the Secretary of State as justification for U.S. trade liberalization. Desire to maintain continued improvement in United States-Soviet relations is a consistent theme in State's inputs to the interagency East-West trade policy process and, therefore, has a certain operational dimension. Interagency deliberations on individual export licensing decisions, the advantages of a long-term agreement, and the North Star liquid natural gas project ^{1/} were characterized by a concern that adverse U.S. Government decisions would interrupt the momentum of detente. The objective of promoting trade as a diplomatic instrument or as an indirect influence for moderating Soviet diplomatic behavior appeared frequently in pre-trade agreement White House policy studies.

^{1/}A large transaction under discussion since 1971 between a U.S. consortium and the Soviets involving Soviet purchase of nearly \$4 billion in U.S. equipment and services on credit in exchange for Soviet natural gas.

As a practical matter, however, there is no evidence that the U.S. Government has consciously attempted to manipulate trade in exchange for Soviet diplomatic concessions. Although general diplomatic objectives are motivating factors during U.S. Government interagency discussions, they are not consciously pursued in diplomatic negotiations with the Soviets, where they would matter the most. There is no evidence, for example, that any Soviet foreign policy concessions were sought or obtained by the executive branch during negotiations for the 1972 Trade Agreement or the 1974 Long-Term Agreement. Nor have such concessions been sought or obtained in exchange for the extension of credits or favorable decisions on export licenses. No effort has been made to withhold approval of individual commercial transactions in exchange for diplomatic benefits or to structure such transactions so as to maximize future U.S. bargaining leverage on Soviet diplomatic behavior.

Furthermore, there is a lack of rigor and consistency within the U.S. Government in articulating desirable diplomatic benefits of trade. Various agencies, and officials within agencies, disagree on what these benefits are or should be. The achievement of interdependence between the two countries, and the constraints this will impose on the foreign policy behavior of both, is the most frequently cited advantage of trade. Yet, the plausibility and implications of interdependence is not fully understood within the Government and has not been thought through conceptually or tested empirically. Finally, the wide differences in bureaucratic perspective and interest inhibit the use of trade as an instrument of diplomacy. The concept of linkage implicitly assumes effective central control over the sources of leverage and some bureaucratic consensus on when and how to apply this leverage, which does not presently exist.

Given a greater understanding of and willingness to pursue commercial/diplomatic linkage through U.S.-Soviet trade, there would still be a need for more direct U.S. Government participation in the trade relationship. Ultimately, it is the basic difference between political and economic systems which limits U.S. ability to effectuate a policy of linking Soviet diplomatic behavior to U.S. trade liberalization. In effect, symmetry of commercial interests between U.S. companies and the Soviets renders U.S. Government diplomatic objectives irrelevant. The Soviets can satisfy their prime objective of U.S. technology inputs by dealing directly with the companies and not sacrificing diplomatic flexibility in government-to-government negotiations. The U.S. Government

seeks a long-term interdependence but has little control over technology transfer, which is the most powerful incentive for Soviet moderation. The Soviets seek short-term technology inputs from private corporations which do not necessarily respond to national interests and are not compelled by the Government to do so. Thus, despite the articulation of interdependence as a long-range U.S. Government objective, both the short- and long-term substance of the trade relationship is a product of what happens--commercially and technologically--at the enterprise level, not at the government-to-government level.

Thus, as existing U.S. Government restraints on trade are reduced, U.S. diplomatic leverage will decline. Without a simultaneous increase in other means of control, the United States may find itself unable to manipulate trade for any purpose without risking major diplomatic repercussions. Any effort to implement the desire for linkage, therefore, will require substantial reform in the U.S. Government-industry interface.

COMMERCIAL BENEFITS

Future prospects for U.S.-Soviet trade remain optimistic. Soviet interest in U.S. products and technology is matched by avid competition among U.S. companies to develop the Soviet market. The major reservation about such trade growth rests in the capacity of the Soviet Government, with its monopoly over all foreign trade decisions, to abruptly alter the volume, direction, and commodity content of trade. A return to economic autarchy by the Soviets, or merely a shift away from U.S. suppliers, is always a latent possibility in Soviet trade policy. Yet, given the probability of expanded trade, a re-orientation in the U.S. Government approach is required, from a largely promotional emphasis toward greater stress on improving the balance of commercial benefits.

Although U.S. sales have increased, little attention or effort has been devoted to modifying the effects of Soviet buying power on private enterprise or collective national benefits. When a market economy sells to a centrally planned economy like the Soviet Union, the buyer maintains a monopoly position within its own economy and faces a multiplicity of competing suppliers. The resulting imbalance of bargaining leverage favors the buyer and has a powerful influence on the balance of commercial benefits. The U.S. venture into the Soviet market has resulted in substantial sales for U.S. companies and an important balance-of-trade increment, but a genuine normalization of commercial relations awaits an effective response to this problem of negotiating imbalance.

Sources of commercial imbalance

The principal sources of commercial imbalance are the centralization of the Soviet economic system and the superior buying power this system generates. The Soviet trade regime presents some unique and sometimes insoluble problems for U.S. Government and company negotiators. The Soviet Government makes all purchasing decisions, based on undisclosed criteria and implemented through obscure bureaucratic processes. Thus, it maintains maximum flexibility in the treatment of U.S. products. Discrimination against foreign products by a market economy is usually discernible by analyzing tariffs and non-tariff barriers, but discrimination by the Soviets in favor of domestic, Eastern European, or other Western suppliers is virtually unverifiable.

This essential character of the centralized system has been a source of constant befuddlement to Western trade negotiators, in both bilateral negotiations with centrally planned economies and multilateral negotiations for protocols of Eastern European accession to the General Agreement on Tariffs and Trade. The natural inclination of Western countries, including the United States, to apply traditional precepts of trade policy (all concessions should be reciprocal, all import protection should be through tariffs) to East-West trade has failed to achieve a genuine balance of concessions. The conclusion which seems to have emerged from this experience, and a basic principle in U.S. planning for the 1972 Trade Agreement negotiations, was the impossibility of extracting equivalent Soviet concessions for a U.S. grant of most-favored-nation treatment.

The inherent nonnegotiability of genuinely reciprocal Soviet trade concessions confronts U.S. companies with a regime whose structure is essentially unchanged from the pre-trade agreement period. This has some important commercial implications for U.S. companies. The difficulties of monitoring and identifying the sources and instruments of any Soviet discrimination against U.S. products limits the degree of leverage the U.S. Government can apply in defense of U.S. company interests in the Soviet market. Furthermore, the secrecy and centralization with which Soviet purchasing plans and decisions are made places U.S. firms on the defensive. Although the broad outlines of Soviet economic requirements are clear, the Soviets buy what and when they want, not necessarily what they need in any economically predictable sense.

The U.S.-Soviet Trade Agreement's focus on improving business facilities and increasing the number of firms accredited to do business in the Soviet market represents an

effort by the Government to apply the traditional trade policy objective of market access to U.S.-Soviet trade. However, achievement of this objective is not likely to enhance commercial reciprocity to the extent that it would in a free market economy. This discrepancy between market access and reciprocity is a result of the superior buying power of Soviet foreign trade organizations. This basic element in Soviet trade practice is likely to limit the corporate and national benefits accruing to the United States. And it is this capability which, despite prolonged negotiation with the Soviets preceded by extensive U.S. Government study, has been undiminished by either reform of the Soviet trade regime or more active and supportive U.S. Government participation in the relationship.

The implications of Soviet buying power for U.S. commercial and national interests are significant. At the enterprise level, the Soviets have successfully manipulated competition among U.S. and other foreign manufacturers and banks. As a result, there is evidence that at least some U.S. firms have not achieved their normal levels of profitability. The Soviets have also stimulated competition among certain U.S. high-technology companies in order to maximize the uncompensated transfer of technology, some of which has been strategically sensitive. Commodity markets, particularly grains, have suffered the inflationary shocks of unrestrained Soviet buying. The negotiation in October 1975 of the long-term grain supply agreement is partially intended to provide some degree of Government monitoring and approval.

In sum, the United States has not achieved commercial reciprocity in trade with the Soviet Union. This imbalance in commercial benefits is attributable to the basic differences between the two economic systems. A multiplicity of corporate entities, whose motivations are often subnational and parochial in character, confronts a buyer that bases all purchasing decisions on its national interests. This basic incompatibility in systems limits the negotiating leverage of U.S. firms and compromises the U.S. Government's ability to support commercial interests or to protect broad national interests.

U.S. Government capacity to maintain a balance of benefits

The organization of the Government in the East-West trade area reflects very little appreciation for, or adjustment to, the unique and difficult interface between the U.S. and Soviet economies. There is little desire or ability to monitor and evaluate the balance of commercial benefits. The agencies

most sensitive to the balance of diplomatic benefits either have no commercial policy responsibility (Defense) or view trade as an instrument of foreign policy (State). The agencies that pursue trade as an end in itself and have direct commercial responsibilities are preoccupied with market access rather than with the balance of benefits (Commerce and Treasury). The agency most concerned with commercial reciprocity (Office of Special Trade Representative) has not been intensively involved in East-West trade policymaking.

As trade continues, the absence of any operational definition of reciprocity has important implications at the enterprise level. With some exceptions, the trade relationship proceeds with very little guidance from the Government. Promotional activities are not differentiated; firms are encouraged to sell, with little advice on what to expect in terms of profits, the long-term efficacy of "buying in," or other guidelines based on the experience of other firms. Thus, companies are compelled to rely upon their own organizational memories, which may be quite short, given the intermittent character of U.S.-Soviet trade.

In the context of government-to-government trade negotiations, the problems identified here reduce the ability to select Soviet concessions which would be most likely to satisfy U.S. commercial interests. It is possible, of course, that any concessions the Soviet system permits have already been made and that the imbalance in negotiating leverage will persist regardless of any future U.S. Government position. Yet, the definition of objectives and the development of options for U.S.-Soviet commercial discussions are quite unsystematic.

Agerdas and briefing materials for the periodic Joint U.S.-U.S.S.R. Commercial Commission meetings reflect no periodic evaluations of the balance of benefits or the sources of Soviet commercial success. They tend to be warmed-over versions of materials prepared for previous meetings. These materials are based almost entirely on the 1972 Trade Agreement, which, in itself, does not embody a balance of benefits and may not have reflected the full weight of U.S. negotiating leverage at that time.

Neither the Trade Agreement nor the 1974 Long-Term Agreement embody commitments or principles intended to modify the effect of Soviet buying power on direct purchases of industrial equipment and technology or agricultural commodities. These agreements contain no outlines of any long-term strategy

designed to induce incremental improvements in Soviet trade practice. Implementation of the Trade Agreement, not what has happened in the marketplace, has become the standard of success in U.S.-Soviet trade.

This lack of direction in U.S. commercial policy is reflected in a clear pattern of Soviet Government initiatives and U.S. Government responses. The 1972 and 1974 agreements resulted from Soviet initiative and both are consistent with traditional Soviet emphasis on formal, bilateral government treaties and institutions in the commercial field. They are not compatible with traditional U.S. trade policy, which avoids bilateralism and seeks to enlarge multilateralism in trade and payments. Both agreements represent conventional Soviet efforts to achieve prior Western government approval for commercial transactions. In sum, the initiative for shaping and altering the trade environment, at both enterprise and government levels, rests with the Soviets.

One further source of Soviet bargaining power is a lack of coordination among the major Organization for Economic Cooperation and Development (OECD) countries (the United States, European Community, and Japan) in their pursuit of expanded East-West trade. There are significant opportunities for common OECD approaches to such issues as export credit, Soviet trade reform, and destructive corporate competition for the Soviet market. However, these opportunities have not been realized as individual OECD countries have negotiated exclusive bilateral arrangements with the Soviets designed to achieve special market preference for their national companies. This rampant bilateralism and failure to apply effective multilateral restraint has redounded to the collective disadvantage of OECD countries.

This unwillingness to coordinate East-West trade policy takes a number of forms. No serious efforts have been made to rectify the imbalance in commercial negotiating leverage between the Soviets and OECD member countries, to establish guidelines for orderly competition in the Soviet market, or to regularly exchange information among OECD governments on the experiences of their firms in negotiating for Soviet sales. Common efforts to reform the Soviet trade regime have been undertaken through the European Security Conference, but the reforms ultimately agreed on related largely to market access rather than to commercial reciprocity. Efforts to coordinate export credit policy have failed consistently. Measures necessary to protect global commodity markets against disruptive Soviet buying have not been taken. In sum, it appears that the lack of U.S. Government adjustment to the unique character of Soviet trade has its mirror image on the international level.

Given this lack of OECD cooperation and apparent Soviet resistance to commercial reform, the basic response to the imbalance in commercial benefits must come through more active U.S. Government participation in the trade relationship. The present lack of Government control over the activities of U.S. firms precludes withholding potential benefits in exchange for improved commercial practice. The lack of direct Government support and advice to U.S. firms participating in contract negotiations leaves unimpaired the Soviet ability to manipulate the competition. Finally, the lack of Government control over U.S. company commercial negotiations compromises the Government's ability to fully protect U.S. national interests, which include:

- Developing reliable recipients for U.S. private and public investments.
- Preventing destabilizing Soviet buying in U.S. or global commodity markets which could inflate U.S. prices and preclude satisfying traditional foreign customers.
- Preventing technology seepage through technology protocols and presale discussions.
- Maximizing aggregate company profitability.
- Preserving U.S. alliance relationships and the integrity of the western trade and payments system.

The U.S. Government recognizes the potential discrepancy between commercial and national interests, as evidenced by export control regulations and procedures and Eximbank and National Advisory Committee responsibilities. However, the full range of interests involved are not reflected nor adequately protected by these sources of Government influence.

AGENCY COMMENTS AND OUR EVALUATION

The East-West Foreign Trade Board responded that the report assumed, without real evidence, that (a) the economic benefits of trade favor nonmarket economy countries (b) Soviet state trading enterprises enjoy a preponderance of power in negotiations with U.S. companies, and (c) the United States accepts short-term commercial disadvantage in order to influence future Soviet actions.

The classified report is replete with evidence on each of these matters, most of it taken directly from executive branch records and from interviews with key officials. Our discussion of these points focused on the Soviet Union, and we recognize they are less applicable to other nonmarket economy countries.

The United States has enjoyed a healthy surplus in its trade with Communist countries. Nevertheless, the Soviets enjoy superior negotiating leverage because of their position as a single buyer with many competing sellers. The Soviet ability to manipulate this competition for sales and the inherent nature of their trading practices makes the tendency for aggregate benefits in their favor.

A Conference Board report showed, for example, that American firms have not attained normal levels of profitability in the Soviet market. Our reports on the 1972 Soviet grain sales showed that Soviet bargaining power over several partially informed sellers allowed the Soviets to buy wheat at bargain prices. U.S. grain exporting company returns were quite low and in some cases were below cost. The East-West Trade Policy Committee recently concluded that the U.S. Government should consider significantly different procedures for regulating trade with Soviet organizations than for trade with most other nations. The Committee also concluded that aside from cash sales, the overall benefits of a proposed major transaction were heavily weighted in the Soviet's favor.

The literature on "monopsony" firmly establishes the superior negotiating leverage of the single buyer. Finally, the pre-trade agreement White House policy studies contain numerous expressions of concern about the advantages of state trading regimes as they face a decentralized market economy like the United States and about whether the U.S. Government should take a more active role to match the superior negotiating leverage of the state trading regimes.

With regard to the United States accepting short-term commercial disadvantages in order to influence future Soviet actions, this theme appeared frequently in the pre-trade agreement policy studies. It has been frequently cited in congressional testimony by key executive branch officials as justification for U.S. trade liberalization. The economic benefits cited earlier that accrue to the Soviets demonstrate the short-term commercial disadvantages to the United States.

U.S. bilateral efforts to achieve reciprocity in U.S.-Soviet trade were designed to establish a position for U.S. companies in the Soviet market and to ameliorate adverse market conditions. U.S. efforts to expand trade have achieved limited market access but have not effectively responded to the negotiating imbalance.

The Board said that we recommended much greater U.S. Government direct involvement in individual commercial negotiations and transactions to control strategic and non-strategic exports in exchange for diplomatic or economic concessions and that we argued that this intervention was necessary to increase bargaining leverage, maximize aggregate company profitability, and prevent technology seepage.

However, the major thrust of our recommendations for Government involvement is to protect U.S. national interests and modify the present Government-industry relationship to permit more direct and effective support for commercial interests in the Soviet market. These are significant reasons for Government involvement. Indeed, the executive branch's own recent initiative in negotiating a long-term grain supply agreement with the Soviets gives recognition to the legitimacy of the thrust of our recommendations.

We did not recommend the exchange of strategic exports for diplomatic or economic concessions. Such exports are clearly prohibited by law. Furthermore, our report demonstrates the current inability of the executive branch system to control strategic exports. It shows the need for greater Government involvement, because of the adversary character of U.S.-Soviet diplomatic and strategic relations, and the implications of technology seepage and ineffective export controls for national security.

RECOMMENDATIONS

United States-Soviet trade is beneficial for both parties, but negotiating advantages accruing to the Soviets distort the commercial and national balance of benefits. Our recommendations are designed to increase commercial and diplomatic returns from future trade by:

- Improving executive branch understanding of the nature and implications of differences between the two economies.
- Structuring the bilateral relationship to create more powerful incentives for improved Soviet commercial practices.

- Increasing the degree of executive branch involvement in U.S. company-Soviet commercial negotiations in order to fully protect U.S. national interests and to permit more direct and effective support for commercial interests.

These objectives should be pursued by reforms at four levels.

Government level

The East-West Foreign Trade Board should direct the National Security Council to authorize a major empirical interagency study on the problems of trading with centrally planned economies. The increasingly heterogeneous character of international trade requires reevaluating whether present international norms and institutions and limited U.S. Government participation in corporate activities adequately protect commercial and national interests. The study should include:

1. How the Soviet monopsony functions, how its purchasing priorities are developed and implemented, and how this affects U.S. corporate market behavior.
2. The effectiveness of internal Soviet bureaucratic procedures.
3. The commercial ramifications of asymmetry.
4. The elements for success in the Soviet market.
5. The efficacy of alternate corporate strategies.

A major focus of the study should be on policy instruments required to use trade for diplomatic purposes.

The Secretaries of Treasury and State should grant the East-West Foreign Trade Board full responsibility for determining broad policy objectives, with the details of managing bilateral meetings and exchanges delegated to its working group. The Board should report the results of its deliberations directly to the President.

The Special Trade Representative's Office, with its focus on the Western trade system, should upgrade its East-West trade capability and become more active in the interagency process.

The Secretary of Commerce should require that the Bureau of East-West Trade's:

- Staff work for the East-West Foreign Trade Board and working group be centered in an improved Office of East-West Trade Policy and Analysis.
- Leadership improve coordination among its offices and, in particular, insure full and ready access to information in the Office of Trade Development Assistance.
- Office of Trade Policy and Analysis upgrade the number and quality of its personnel and have more explicit and coherent direction from office and bureau levels. As its analytic capability improves, the Office should reduce its dependence on external consultants.

The Secretary of the Treasury should require that the East-West Foreign Trade Board regularly discuss future research priorities and communicate these priorities directly to the Bureau of East-West Trade, State's Bureau of Intelligence and Research, and the Central Intelligence Agency. The results of this analytic work should be discussed periodically by the working group and the Board.

The Secretaries of State, Treasury, Commerce, and Defense should use the authority in the Trade Act, or should request new authority if necessary, to establish a monitoring system requiring prior notification of all technology protocols with the Soviet Union and Eastern Europe and of normal commercial transactions exceeding a certain amount. Data provided should include specific contract terms and, on an anonymous basis, contract prices, costs, and financing techniques and amounts.

The Secretary of Commerce should require the Bureau of East-West Trade's Office of Trade Development Assistance to use existing data and data resulting from the new monitoring system to develop an easily retrievable information system. The Office should also more actively solicit information from U.S. firms on the impediments they face in the Soviet market.

Bilateral level

The Secretaries of State, Treasury, and Commerce should insure that the conclusions emerging from the interagency study and the continuous analytic efforts recommended above form the bases for the U.S. position in Joint U.S.-U.S.S.R. Commercial Commissions and other bilateral negotiations and discussions. Diplomatic missions by individual department

representatives should be fully coordinated through the East-West Foreign Trade Board and should reinforce previous U.S. Government positions.

Bilateral discussions between the United States and the Soviet Union should focus more on Soviet buying behavior in commodity and industrial markets and less on issues related to market access.

Multilateral level

The Secretaries of State, Treasury, and Commerce and the President of Eximbank should pursue credit harmonization as a long-term feature of U.S. export credit policy rather than as a temporary expedient to use or avoid depending on short-term bilateral commercial calculations.

The Secretary of State should:

1. Consider negotiations to grant OECD a permanent role in monitoring and enforcing the gentleman's agreement on credit harmonization. The United States should also join the prior consultation procedure, which should be extended to Eastern Europe and the Soviet Union.
2. Initiate discussions on prospects for joint financing of major projects as a regular practice with other OECD countries active in East-West trade.
3. Consider negotiating a commercial information exchange system on East-West trade within OECD.
4. Insure that the results of the European Security Conference Basket II discussions ^{1/} receive continuing attention by assigning monitoring responsibility to the Economic Commission for Europe. U.S. representation at the Commission should be upgraded, and U.S. bilateral discussions with the Soviets should reinforce Basket II commitments.

The Special Trade Representative and the Secretary of State should initiate:

^{1/}The European Security Conference was a Soviet initiative designed to settle outstanding European strategic, economic, and welfare issues. All major East and West European countries, plus the United States and Canada, participated. Basket II encompasses economic aspects of the Conference.

1. General Agreement on Tariffs and Trade discussions on a catalog of East European and Soviet impediments to trade as part of the General Agreement on Tariffs and Trade general nontariff barrier identification exercise.
2. OECD discussions on a code of government and corporate practices to narrow disparities in approach and to reduce competition among OECD governments in East-West trade. The code should also encompass rules protecting the Western trade and payments system from the prevailing bilateral orientation and a timetable for phasing out the various bilateral agreements.

The Secretaries of State, Treasury, and Commerce should pursue proposals for cooperation among enterprises interested in exporting to the Soviet market.

Government-industry level

The Secretaries of State, Treasury, and Commerce should avoid any premature commitments to commercial transactions.

The East-West Foreign Trade Board should use information from the monitoring system to review all transactions that require Eximbank credits and should either approve or withhold approval depending on the national interests involved and the potential for commercial concessions in exchange for approval.

The Secretary of Commerce should:

1. Request legislation establishing the Government's authority to preclude presale discussions of strategically sensitive technologies. Commerce should develop a catalog of technologies for which U.S. firms have a monopoly but which could be exported without injury to national security. Such technologies should provide bargaining chips for Soviet concessions.
2. Instruct the Bureau of East-West Trade to more actively support corporate interests in the Soviet market. This should involve more sophisticated and detailed advice to interested companies based on the results of the analytic exercises recommended above. The Bureau should also facilitate an exchange of information among competing U.S. suppliers and should approach the Soviets directly in cases involving particularly objectionable buying behavior.

The Secretary of the Treasury, in his capacity as Chairman of the East-West Foreign Trade Board, should use data resulting from the monitoring system to review all transactions involving other national interests, such as commodity price stability and supply, technology seepage and security of investments, as well as transactions requiring credit or export licenses. Criteria for involvement could include size of transaction and credit, nature of product or technology, number of firms competing, and structure of the transaction (product payback, for example). The intensity of involvement could vary from indirect guidelines for the firms, to observer status at commercial negotiations, to direct negotiations with Soviet officials, to disapproval of the transaction. The Foreign Trade Board should become involved during the initial discussions to control exports to the Soviet Union in exchange for diplomatic or economic concessions.

CHAPTER 7

SCOPE OF REVIEW

To assess the executive branch role in bilateral and multilateral East-West trade, we reviewed policies, programs, and procedures relating to (1) diplomatic and commercial objectives, (2) policy formation structure, (3) congressional consultation, (4) promotion and financing, (5) export controls, (6) technology transfers, and (7) reciprocity of benefits. We interviewed officials and reviewed activities of the

- 1 National Security Council, 745
- 2 Council on International Economic Policy, 510
- 3 Office of the Special Representative for Trade Negotiations, 302
- 4 Central Intelligence Agency, 210
- 5 Export-Import Bank of the United States, and 17
- 6 Departments of Agriculture, Commerce, Defense, State, and Treasury, 74, 5, 32, 38

We also reviewed the activities of all major East-West trade-related executive branch interagency groups, such as the President's Committee on East-West Trade Policy and its Working Group. U.S. activities in bilateral organizations, such as the Joint Commercial Commissions, were also reviewed. 1, 3, 4, 5, 9

Our work at these executive branch organizations in Washington, D.C., included reviews of the following categories of files, documents, and correspondence: (1) studies, evaluations, and reports, (2) intra- and interdepartmental or organizational memorandums, (3) contributions to interagency studies, interagency organizations, and bilateral organizations, (4) briefing materials prepared for official visits, (5) diplomatic exchanges and cables, and (6) U.S. contributions to multilateral studies of East-West trade.

We examined congressional records, hearings, reports, and legislation on East-West trade and talked with representatives of the Congressional Research Service. We also examined academic and published materials, including press reports, and interviewed representatives of American firms and trade associations in the United States, former Government officials, and representatives of U.S. private and Communist government organizations.

During visits to Moscow, Warsaw, Budapest, Vienna, Geneva, Brussels, Bucharest, Bonn, Paris, London, Berne, Prague, Tokyo, Hong Kong, and Singapore, we interviewed appropriate officials and examined pertinent data at U.S. Embassies and consulates,

12 trade centers, and Missions to such international organizations
13 as the NATO, the General Agreement on Tariffs and Trade, U.N. ^{2112 01338}
14 Economic Commission for Europe, OECD, European Community, and ^{DLG 51116}
COCOM. We also interviewed representatives of these interna-
tional organizations and foreign governments (except for those
of the Soviet Union, Eastern Europe, and the People's Republic
of China), American and foreign firms, foreign business associa-
tions, publishing houses, and the American Chamber of Commerce. ^{111 01111}

ACCESS TO INFORMATION

Executive branch organizations were concerned that our review might harm U.S. Government efforts to encourage East-West trade by creating an impression of uncertainty regarding U.S. positions.

Our work overseas was restricted because we were unable to talk with host government officials in the Soviet Union or Eastern Europe and we were unable to go to Peking or to talk with People's Republic of China representatives in Hong Kong. Although State Department cooperation overseas was generally responsive to our needs, there were instances of less than adequate cooperation. State would not agree to allow our representatives to discuss the Coordinating Committee for strategic export controls and the Conference on Security and Cooperation in Europe with British and West German officials.

We did not have complete access to executive branch records and were unable to resolve certain access problems or to establish uniform access guidelines. Access guidelines, promulgated by the White House Counsel's office and the President's Committee on East-West Trade Policy, were that:

1. Each agency decides the question of GAO access to its records.
2. GAO could not have information on subjects for which discussions had not been finalized or subjects still under discussion with other countries.
3. Certain sensitive data would not be made available.

As a result, we faced differing agency guidelines, arbitrary and subjective judgments on which subjects were pending or still under negotiation, and various definitions of sensitive data.

We have not received a reply to our letter of October 10, 1974, which was requested by the White House Counsel's office and which detailed the chronology of events concerning our requests for CIEP and NSC documents and requested a reassessment of previously established access ground rules.

We were also denied access to certain confidential business information, despite written agreement reached with the Commerce General Counsel and the Secretary of Commerce's determination, required by Section 7 (c) of the Export Administration Act, which declared it was in the national interest for GAO to have access to this information.

APPENDIX I

APPENDIX I



DEPARTMENT OF THE TREASURY
WASHINGTON, D.C. 20220

ASSISTANT SECRETARY

October 21, 1975

MEMORANDUM FOR: J. K. FASICK
Director
United States General Accounting Office

SUBJECT: Executive Branch Response to GAO Report:
Trade and Detente -- An Assessment

The following is the response of the East-West Foreign Trade Board to the GAO report entitled "Trade and Detente -- An Assessment." It represents the views of the agencies comprising the Board, and the Department of Defense (see attached list). These comments have been developed through extensive review within the framework of the East-West Foreign Trade Board.

Rather than respond in detail to each of the many findings and recommendations contained in the report, the Board has chosen to focus our observations on the following major areas which the report addresses:

- Overview
- Policy formulation and the use of economic leverage
- U.S. Government intervention in transactions between nonmarket economy countries and American firms
- Export administration
- The financing of East-West trade

Overview

Although there are many recommendations in this comprehensive and detailed study in which the Executive Branch can concur, we find many of the major conclusions on critical and controversial issues are not supported by the facts. Generalizations are implied as valid because contrary and available information is excluded from the report. Moreover, the resulting unsupported conclusions then form the bases of many pages of unsubstantiated comments and recommendations.

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We also find the tone of the report misleading in some instances. By quoting at length the widely differing opinions of many parties with conflicting interests and viewpoints regarding East-West trade policy and export administration, the report tends to suggest that Executive decision making is characterized by divisiveness, inconsistencies and uncertainty.

Given the controversy surrounding East-West trade and export administration, it is a simple matter to find diverse views: there is a body of reasoned support for almost any viewpoint. However, controversy should be expected and, indeed, welcomed. Differing agency perspectives require constant review, at every level of Government, for each major policy initiative. The Board believes that these thorough and vigorous interagency discussions have, on the whole, produced East-West trade policies and export administration procedures that are realistic and effective. Additionally, we find the report focuses almost exclusively on U.S. economic and political relations with the Soviet Union. In fact, however, East-West trade policy encompasses the broad spectrum of our economic relations not only with the Soviet Union, but with all the nonmarket economies of Eastern Europe and the People's Republic of China.

Policy Formulation and the Use of Economic Leverage (See chs. 2 and 6.)

A key point reiterated in the report is that the benefits of trade have favored the nonmarket economy countries and that few, if any, diplomatic benefits have been derived from the application of U.S. economic leverage. There are sweeping, unsubstantiated allegations charging lack of coordination, failure to formulate clear goals, and inadequate implementation of policy. The GAO cites lack of an overall strategy by the Government, as well as interagency conflict, as underlying causes of this disarray.

The report fails to recognize that the strength of interagency committees and boards derives from the process of melding and reconciling major differences in viewpoint. This productive and creative form of interaction has served to ensure that major policy initiatives are consistent with the principal economic, political and military objectives pursued by the U.S. Government.

Although interagency coordination, analysis, and decision making in 1972 were admittedly imperfect to deal with the new situation created by detente and expanded commercial initiatives, the establishment of the East-West Trade Policy Committee in March 1973 marked a significant improvement. Its successor organization, the East-West Foreign Trade Board, has further strengthened the decision-making process in accordance with its legislative mandate.

The goals we seek in our developing economic relationship with the nonmarket economy countries are multifaceted. There are positive economic benefits to the U.S. in the expansion of its trade with the nonmarket economy countries. They represent a significant market for both U.S. agricultural and manufactured goods exports and an important source of U.S. requirements for imported raw materials. Consequently, a U.S. failure to realize the potential economic benefits of East-West trade could have an adverse effect on U.S. export earnings, without a commensurate reduction in U.S. imports, and thus an undesirable net effect on U.S. domestic employment and balance of payments.

In addition, this developing relationship may offer some contribution to international stability and provide some motivation to the nonmarket economy countries to exercise restraint in the conduct of their foreign and domestic policies. The development of economic ties is a significant component of this relationship.

The GAO report exaggerates the significance of U.S. trade with the U.S.S.R. and other nonmarket economy countries in the process of detente, and thus the degree to which the United States can or should attempt to use trade as a lever to exact concessions. While trade and economic ties may improve the environment for progress on political issues, trade is not, as the report asserts, "the policy instrument used to achieve political progress."

From the outset, the Administration relied on three different types of policy controls to ensure a coherent and consistent approach to trade with the U.S.S.R.:

- o On the political level, it was made clear from the outset that progress on the economic front would follow very closely on the resolution of key political issues. It was following breakthroughs on Berlin, SALT, and other arms control matters in 1971 and a successful summit in 1972 that we expressed a willingness to move forward on a broad economic front as a companion piece to continued comparably broad progress on the political front. The further normalization of our economic relations continues to be examined in a broad political framework.
- o Financial control over Eximbank credit was exercised within the Bank by applying standards consistent with its legislative charter and normal lending practices to any other borrowers. When Eximbank lending authority is restored, as we hope it will be, it will again be applied according to standard Exim procedures and whatever guidelines may be established by Congress.
- o The existing U.S. export control system, consisting primarily of munitions controls (State), atomic energy controls (ERDA and NRC) and the Export Administration Act (Commerce), serves to control transfers of both embodied and disembodied technolo-

to protect the national security. In practice, the system precludes the export or reexport of sensitive technology and the transfer of information determined to be strategic and to control transmission of all unpublished technical data which may adversely impact the national security.

The Administration does not believe that the expansion of the U.S. role in East-West commerce can or should be made dependent upon quantifiable progress toward specifically defined, discrete, short-term political objectives. On the contrary, on one very basic objective, freedom of emigration, the Administration counseled against specific linkage to the granting of most favored nation (MFN) tariff treatment and official credits of these countries. Experience has indicated the counterproductive effect of establishing an explicit quid pro quo in this instance.

Among the reasons for an exaggerated view of U.S. leverage is the failure to appreciate the existence of competitive alternative Western sources of supply. In fact, the U.S. role in East-West trade is small. Trade between the nonmarket economies and the countries of the Industrial West amounted to \$43 billion in 1974; of this, the United States accounted for only \$3.2 billion, or about 7 percent.

Commercial exchange between East and West will continue to expand, whether the U.S. increases or decreases its share in this trade.

The GAO report recommends that the U.S. seek to improve Western coordination of trade policy toward the nonmarket economy countries. Such coordination is clearly desirable, and it already exists, on a day-to-day basis, in the framework of the COCOM strategic control system. However, in many areas, including credit harmonization, the role of GATT, and the multilateral trade negotiations, East-West trade issues are intermingled with issues which are internal to the Western community, complicating efforts to develop a coordinated Western position. The U.S. Government is pursuing with its allies the problem of assuring and monitoring the implementation of provisions of Basket II of the Conference on Security and Cooperation in Europe. Trade with the nonmarket economies is a matter of varying economic significance among the Western countries, however, and the degree of willingness to sacrifice the gains of trade for political objectives also varies from country to country. Thus, the amount of leverage the U.S. can exert on its Western allies in forming unified positions is seriously limited. Without such unified positions, unilateral U.S. economic leverage can be exercised only within an extremely limited sphere.

The recurrent reference to tradeoffs of U.S. economic concessions for political and security benefits ignores the record of the Executive Branch in developing and negotiating an array of economic mechanisms specifically tailored to meet the special problems of interface between market and nonmarket economies. In the case of Romania we have negotiated a trade agreement that contains rigorous safeguards against disruptive imports

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while providing U.S. companies with extensive rights and assurances in carrying out business in that country. In addition, we secured Romanian acknowledgement that special arrangements with nonmarket economy countries are needed to ensure reciprocity of concessions. In the case of Romania this involved Romanian recommitment to its GATT accession instrument under which Romania guarantees to increase imports from market economy countries at at least the same rate as the increase in total imports called for in its five-year plans.

In concluding this trade agreement our negotiators were supported by requirements in the Trade Act for substantial and meaningful commercial concessions in exchange for MFN status. These requirements were based on the provisions of the trade agreement negotiated with the U.S.S.R. in 1972. The Act also contains carefully drawn provisions ensuring that all agreements entered into in the Multilateral Trade Negotiations with market and nonmarket countries contained reciprocal economic benefits for the United States. In both negotiations the Administration has worked closely with Congress to ensure that these requirements of the Trade Act are implemented. However, the requirements of the Trade Act concerning emigration have impeded progress in our trade relations with the U.S.S.R. and other nonmarket countries, denying us the opportunity to obtain similar concessions of benefit to U.S. companies.

U.S. Government Intervention in Transactions between Nonmarket Economy Countries and American Firms (See ch. 6.)

The report assumes without real evidence that the economic benefits of trade favor the nonmarket economy countries, that the Soviet state trading enterprises enjoy a preponderance of power in negotiations with U.S. companies, and that the U.S. "accepts short-term commercial disadvantage in order to influence future Soviet actions." The report recommends a much greater direct involvement of the U.S. Government in individual East-West commercial negotiations and transactions, and the utilization of this involvement to control exports--both strategic and non-strategic--in exchange for diplomatic or economic concessions. The report argues that this intervention is necessary to:

- o increase bargaining leverage and "maximize aggregate company profitability"; and
- o prevent "technology seepage"

The report states that U.S. companies engaged in negotiations with Soviet state-trading enterprises are disadvantaged by the monopoly buying power of the Soviets. This monopoly power means, says the report, that gains from trade asymmetrically favor the Soviet Union.

This thesis is by no means proved. There is no evidence that American (or other Western) companies regard profit as of lesser importance in transactions with the U.S.S.R. than with other countries, as the report asserts, and there is no evidence that companies engaged in East-West trade

suffer lower rates of return. Companies which find the return on business with the U.S.S.R. unsatisfactory can be expected to turn to other areas in which returns are higher. Although Soviet state-trading companies have monopoly buying power with regard to the Soviet Union, the Soviet market is often small in global terms. To the extent that size confers bargaining power, American corporations, especially those which control important shares of the world output of a given product or service, are well positioned to hold their own. Still, the report contends that Government intervention is required to redress the alleged imbalance, particularly in the context of the grain trade.

In assessing the issue of monopoly buying power we should note that the grain trade differs to some extent from trade in industrial goods and services principally because supplies of agricultural commodities are somewhat inflexible at certain times in the crop year. While the impact of Soviet purchases of American grain on the American and international markets in the past stemmed in part from the Soviet state's ability to mask its requirements and time its purchases to obtain a price advantage, the principal concern in terms of U.S. interests is the enormous variation in Soviet purchases from year to year. We have learned certain lessons from the experience of the 1972 grain sales, and efforts to work out a long-term agreement to deal with these problems are under way.

Otherwise, as a matter of policy, the Administration has attempted neither to participate in commercial negotiations carried out by private firms nor to ensure that U.S.-Soviet transactions result in profits for the American companies involved. Were the U.S. Government to seek to "maximize aggregate company profitability" in U.S.-Soviet trade, as the report recommends, the question of fairness to American firms not engaged in trade with the Soviet Union would surely arise. Empowering Government officials to participate in commercial negotiations, authorizing them to use export controls to disapprove transactions on commercial grounds, and instructing them to maximize the profits of American firms could only result in distortions of trade, and would entail massive surveillance by the U.S. It would necessitate a large and cumbersome bureaucracy, and would hamper U.S. firms' efforts to compete effectively. It would bring U.S. firms under increased control by the U.S. Government and would run counter to the free enterprise system. Furthermore, using the export control mechanism to obtain commercial leverage for American firms would either place the Government in the position of negotiating on behalf of U.S. companies, or, by provoking adverse Soviet reaction, disadvantage American companies relative to their competitors.

With regard to the matter of technology seepage, the Administration has sought to apply export controls to prevent the transfer of technology to nonmarket economy countries when such technology would likely be applied to enhance military capabilities. It believes that it has been successful in carrying out the laws in this regard.

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Export Administration (See chs. 4 and 5.)

The report succeeds in identifying some of the more difficult issues associated with effective management of the current national and international systems of export controls. Specifically, it cites difficulties in the relationship between U.S. and COCOM objectives and control mechanisms; potential for technology seepage; the diverse perspectives on the economic costs/benefits of the system; the delays placed on the U.S. business community; and the complexities of adapting the system to serve the differing perspective of the major agencies--State, Commerce and Defense--which are involved in export regulation.

The report is less successful in formulating precedural recommendations, several of which are based on misconceptions of current operating procedures. These include, but are not necessarily limited to, the following:

- o The recommendation that the Department of Commerce should be relieved of the licensing and monitoring of technology cannot be supported, since it fails to recognize that the licensing of trade in technology is an integral part of Commerce's overall licensing effort. It would be difficult, for example, to segregate the issues involved in licensing a given piece of equipment from those raised by the sale of the technology associated with the same item. On the contrary, we support the report's recommendation that Commerce's role in upholding and licensing of U.S. national security controlled commodity exports should be strengthened since that agency has been delegated by the President the authority to administer U.S. export controls in light of the broad concerns--foreign policy, national security, short supply--which must be reflected in a coherent system of export administration.
- o The report fails to recognize both the difficulties inherent in controlling exports of technology and the full extent of Commerce's mechanism to effect such control. The deliberations accorded proposed technology exports are often more protracted than those required for equipment sales because of the strategic concerns examined and reviewed when exporting technology which impinges on an area where the end product may be strategic and may involve possible strategic end use.
- o The study fails to recognize that the function of the Operating Committee is not to establish policy or to decide individual cases, but rather to secure advice and recommendations for the Department of Commerce from its advisory agencies. To establish that the advice and recommendations of the majority shall be accepted, as recommended by the report, would distort the purpose of the Committee and detract from its utility.

- o The report shows a poor understanding of the historic role of the State Department and COCOM in export control and of the distinctions between multilateral and U.S. export control issues. With respect to the relationship of the Battle Act determinations to the U.S. position in COCOM, the report fails to appreciate that the Battle Act was enacted after the creation of COCOM and was intended to be consistent with, and to support U.S. participation in, COCOM. It is entirely logical and in accordance with the Act that lists of U.S.-controlled items be "continuously adjusted to current conditions" and that the determinations of the Battle Act Administrator (now the Secretary of State) reflect changes negotiated in COCOM. Further, it is not true that "State has greatly curtailed export control work as conflicting with detente". Although the Office of East-West Trade has expanded its functions in other areas, its export control work has not diminished.
- o There is not reason to accept the unsupported assertion that "many U.S. firms have violated export controls" although no doubt some technology has entered the Soviet Union and Eastern Europe in violation of U.S. and COCOM export controls and enforcement procedures. The Soviets have traditionally assigned a high priority to the development of their military capabilities, and have not hesitated to sacrifice civilian needs for this purpose. They will continue to do this, whether or not they trade with the West.

This treatment of export controls is characterized by the pervasive bias of the report in favor of direct involvement by the United States Government in individual East-West commercial transactions, and the utilization of this involvement to control exports--both strategic and non-strategic--in exchange for diplomatic or economic concessions. As stated previously, any such direct U.S. Government intervention would have adverse consequences far outweighing the alleged benefits.

It is recognized that there may be cases of such size and strategic significance that they should not be approved without assurance that the diplomatic, economic or other return the U.S. will obtain justifies the military risk. However, negotiation of strategic controls with the Soviet Union, a course which the report implies should be followed, would in all likelihood destroy the multilateral control mechanism and would have major implications for American security.

As the report suggests, there is a need for more expeditious handling of license applications. The Department of Commerce, in consultation with its advisory agencies, is taking steps to achieve this. Since interagency review is necessary for the more complex, precedental cases which are an ever increasing proportion of the workload, increased staffing in other agencies may ultimately be necessary to speed the review process.

Financing East-West Trade (See ch. 3.)

It is a major overstatement to say that the availability of Eximbank financing is "the most significant stimulator" of trade with nonmarket economy countries. The statistics in the report show that export growth greatly exceeded Exim disbursements in 1973 and 1974 to Poland, Romania and the U.S.S.R.

The report fails to substantiate, yet appears to assume, that Eximbank and other Executive Branch agencies acted intentionally to give preferential treatment to the U.S.S.R., Poland and Romania, compared to other countries. (Under the terms of the Trade Act, only Poland and Romania are currently eligible for additional Eximbank loans. The U.S.S.R., other countries of Eastern Europe and the P.R.C. are ineligible.) It fails to bring out the following realities:

- o Independence of Eximbank Credit Decisions. Eximbank acts globally, as well as in East-West trade, to make its own independent credit judgments in accordance with its legislative mandate, the Export-Import Bank Act. The Congress expects Eximbank to act in accordance with general U.S. foreign and economic policies, as the Bank Directors make their judgments on individual credit applications. The Bank routinely receives views from other U.S. Government agencies about individual cases, but this is done globally, and not just in the case of transactions involving the U.S.S.R., Poland and Romania. The initial decision to make Eximbank facilities generally available to support trade with any nonmarket economy country is made by the President. The Bank does not approve individual credits for political reasons; it considers the creditworthiness of the country, the participants in the transaction and the project itself in addition to other criteria set forth in its legislation.

The report argues that Exim does not have a precise set of criteria for evaluating credit applications and thus Exim may not be giving rigorous analysis to preliminary commitment applications and may give preferential treatment to the Soviet Union. The report oversimplifies the judgments which must be made at the staff and Director level of the Bank. Exim has internal criteria which are applied globally without country preferential treatment. However, each transaction has qualitative as well as quantitative differences. No bank can operate on a rigid quantitative analysis basis to make sensitive credit-worthiness judgments.

- o Eximbank Operating Procedures are Non-preferential. There are mutually agreed procedures for handling Eximbank transactions in a number of countries in the world--not just the U.S.S.R.,

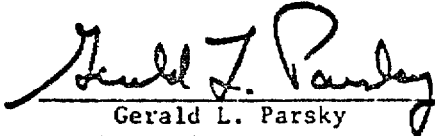
Poland, and Romania--which facilitate monitoring the growth of debt by central authorities in these countries. The objective is as much in Eximbank's interest as a creditor as to the benefit of the country. In each case Eximbank must respect the sovereign right and capability of the foreign government to establish the internal procedures it deems necessary. Poland, Romania and the U.S.S.R. also have bilateral agreements at the government level with France, Japan and the U.K. which establish the basic framework within which Western credits will be made available. Thus, the procedural arrangements followed with these countries do not give them any preferential treatment.

The report claims the Exim harmed U.S. exporters by issuing its preliminary commitments only to Polish and Soviet borrowers, as requested by those countries, rather than to U.S. firms desiring to export to them. Even if Exim were able to provide preliminary commitments directly to U.S. suppliers, U.S.S.R. and Polish authorities would continue to control which suppliers will win the contracts or even be allowed to bid. Considerable investment may be required in preparing bids, a particular drain on medium and small suppliers. False hopes should not be set by issuing a preliminary commitment if there is not serious interest on the part of the potential buyer. Indeed, many suppliers have commented to Exim that they welcome the existing procedure, since they do not have to get involved in the financing aspects in addition to all their commercial contract negotiations.

- o Eximbank Applies Consistent Requirements for Country Economic Information. Eximbank has consistently sought the fullest possible information from all possible sources about the credit-worthiness of countries to which it is lending. These sources include information from all U.S. agencies, the IMF and IBRD and similar regional banks, the U.N., private financial institutions and academic sources. The Bank also solicits information directly from foreign governments where it deems necessary to fill gaps, and this is done with the U.S.S.R., Poland, and Romania. However, some foreign governments have their own strict laws and regulations about release of information beyond certain types which Eximbank cannot override. In any event, Eximbank has made no credit judgments involving any foreign country--including the U.S.S.R., Poland, and Romania--unless it was fully satisfied that it had sufficient economic information.
- o Exim Does Not Displace Private Financing. The discussion of commercial bank willingness to participate in export financing to the nonmarket economy countries overlooks a number of facts which strongly influence commercial lending: the legal lending limit to single borrowers; the Johnson Act restraints on private

lending from the U.S. to countries in default to the U.S.; and internal bank portfolio limits to various countries. Many banks have commented about their inability to participate in credits without more Exim involvement. In fact, rather than competing with private financing through use of its guarantee program, Exim can actually enhance private sector lending capabilities.

When discussing Soviet willingness to pay cash, the report fails to point out that the U.S.S.R. has ample credit available from government sources in Western Europe and Japan. Without similar government-supported export financing from the U.S., the ability of U.S. firms to compete effectively for billions of dollars of Soviet orders will be jeopardized. U.S. companies have already found it necessary to use foreign credit sources to win Soviet contracts by sourcing from abroad goods they had planned to ship from the U.S.


Gerald L. Parsky
Executive Secretary
East-West Foreign Trade Board

Attachment

Attachment to memorandum
to Mr. Fasick from
Mr. Parsky

EXECUTIVE BRANCH RESPONSE TO GAO REPORT:

TRADE AND DETENTE -- AN ASSESSMENT

Participating Agencies

Council on International Economic Policy
Department of Agriculture
Department of Commerce
Department of Defense
Department of State
Department of the Treasury
Export-Import Bank
Office of Management and Budget
National Security Council
Special Representative for Trade Negotiations

PRINCIPAL OFFICIALS RESPONSIBLE FOR
ADMINISTRATION OF ACTIVITIES
DISCUSSED IN THIS STATEMENT

Tenure of office
From To

DEPARTMENT OF STATE

SECRETARY OF STATE:

Henry A. Kissinger	Sept. 1973	Present
William P. Rogers	Jan. 1969	Sept. 1973

DEPARTMENT OF THE TREASURY

SECRETARY OF THE TREASURY:

William E. Simon	May 1974	Present
George P. Shultz	June 1972	May 1974
John B. Connally	Feb. 1971	June 1972
David M. Kennedy	Jan. 1969	Feb. 1971

DEPARTMENT OF DEFENSE

SECRETARY OF DEFENSE:

Donald H. Rumsfeld	Nov. 1975	Present
James R. Schlesinger	July 1973	Nov. 1975
Elliot L. Richardson	Jan. 1973	Apr. 1973
Melvin R. Laird	Jan. 1969	Jan. 1973

DEPARTMENT OF JUSTICE

ATTORNEY GENERAL:

Edward H. Levi	Feb. 1975	Present
William B. Saxbe	Jan. 1974	Feb. 1975
Elliot L. Richardson	May 1973	Oct. 1973
Richard G. Kleindienst	June 1972	May 1973
John N. Mitchell	Jan. 1969	Mar. 1972

DEPARTMENT OF AGRICULTURE

SECRETARY OF AGRICULTURE:

Earl L. Butz	Dec. 1971	Present
Clifford M. Hardin	Jan. 1969	Nov. 1971

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From To

DEPARTMENT OF COMMERCE

SECRETARY OF COMMERCE:

Rogers J. B. Morton	May 1975	Present
Frederick B. Dent	Feb. 1973	Mar. 1975
Peter G. Peterson	Feb. 1972	Feb. 1973
Maurice H. Stans	Jan. 1969	Feb. 1972

OFFICE OF MANAGEMENT AND BUDGET

DIRECTOR:

James T. Lynn	Feb. 1975	Present
Roy L. Ash	Feb. 1973	Feb. 1975
Caspar W. Weinberger	June 1972	Feb. 1973
George P. Shultz	July 1970	June 1972
Robert P. Mayo	Jan. 1969	June 1970

Effective date
of appointment

NATIONAL SECURITY COUNCIL

ASSISTANT TO THE PRESIDENT
FOR NATIONAL SECURITY AFFAIRS:

Brent Scowcroft	Nov. 1975
Henry A. Kissinger	Jan. 1969

COUNCIL ON INTERNATIONAL ECONOMIC POLICY

EXECUTIVE DIRECTOR:

John M. Dunn (acting)	Feb. 1975
William D. Eberle	July 1974
Peter M. Flanigan	Feb. 1972
Peter G. Peterson	Jan. 1971

CENTRAL INTELLIGENCE AGENCY

DIRECTOR:

George H. Bush	Jan. 1976
William E. Colby	Sept. 1973
James R. Schlesinger	Feb. 1973
Richard Helms	Jan. 1969

Effective date
of appointment

COUNCIL OF ECONOMIC ADVISERS

CHAIRMAN:

Alan Greenspan	Sept. 1974
Herbert Stein	Jan. 1972
Paul W. McCracken	Feb. 1969
Arthur Okun	Jan. 1969

OFFICE OF THE SPECIAL REPRESENTATIVE
FOR TRADE NEGOTIATIONS

SPECIAL REPRESENTATIVE FOR
TRADE NEGOTIATIONS:

Frederick B. Dent	Mar. 1975
William D. Eberle	Nov. 1971
Carl J. Gilbert	Aug. 1969

EXECUTIVE OFFICE OF THE PRESIDENT

COUNSELOR TO THE PRESIDENT
FOR ECONOMIC POLICY:

Kenneth Rush	May 1974
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ASSISTANT TO THE PRESIDENT
FOR ECONOMIC AFFAIRS:

L. William Seidman	Sept. 1974
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EXPORT-IMPORT BANK OF THE UNITED STATES

PRESIDENT AND CHAIRMAN:

Stephen M. DuBrul, Jr.	Jan. 1976
William J. Casey	Mar. 1974
Henry Kearns	Mar. 1969

BOARD OF GOVERNORS OF THE
FEDERAL RESERVE SYSTEM

CHAIRMAN:

Arthur F. Burns	Jan. 1970
William McChesney Martin	Jan. 1969

NUCLEAR REGULATORY COMMISSION (note a)

CHAIRMAN:

William Anders	Jan. 1975
Dr. Dixie Lee Ray	Feb. 1973
James R. Schlesinger	Aug. 1971
Glenn T. Seaborg	Jan. 1969

a/ Formerly the Atomic Energy Commission.