

GAO

Report to the Chairmen, Committee on
International Relations and Committee
on Armed Services, House of
Representatives

August 2000

DEFENSE TRADE

**Analysis of Support
for Recent Initiatives**



G A O

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Abbreviations

DOD Department of Defense



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Washington, D.C. 20548

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The Honorable Benjamin A. Gilman
Chairman, Committee on International Relations
House of Representatives

The Honorable Floyd D. Spence
Chairman, Committee on Armed Services
House of Representatives

Last year, the Department of Defense (DOD) compiled a list of 81 defense cooperation initiatives in an effort to enhance cross-border defense trade and investment. Thirty-four of these initiatives were part of an ongoing effort to reinvent the Foreign Military Sales Program.¹ Forty-seven of the initiatives were intended to streamline processes and/or change policies in several areas considered important for defense cooperation, including export controls, release of classified information to foreign countries, procurement from domestic and foreign companies, and industrial security. DOD senior officials saw these defense cooperation initiatives as necessary to achieving three desired outcomes: to improve interoperability in coalition warfare scenarios, to reduce a gap in military capabilities between the United States and North Atlantic Treaty Organization allies, and to ensure that U.S. defense companies successfully compete abroad.

Since the initial compilation of these initiatives, most of DOD's attention has been focused on export controls. Because the State Department has primary responsibility for controlling the export of defense articles and services, the State Department and DOD formed a working group to develop proposals to change the export control process. As a result of State Department and DOD discussions, on May 24, 2000, the administration announced 17 proposals, known as the Defense Trade Security Initiative, to adjust the U.S. defense export control system. As with DOD's initiatives, these proposals are intended to achieve the three desired outcomes identified above.

¹The Foreign Military Sales Program facilitates the purchase of defense articles and services from the U.S. government by eligible foreign governments and international organizations.

Because of your concern about the potential national security implications of DOD's efforts to modify policies and procedures for regulating defense trade and investment, we reviewed as requested the status and basis for DOD's defense cooperation initiatives. In July 2000, we provided a description and status of the 81 initiatives.² As agreed with your offices, in this report we have focused on the basis for DOD's 47 initiatives dealing with defense trade and investment. Specifically, we examined (1) the data and analysis supporting the 47 initiatives and (2) the likelihood that the initiatives will achieve DOD's desired outcomes. Since the administration's Defense Trade Security Initiative was developed in response to industry and foreign government concerns (as were DOD's initiatives), we are also providing information for you to use in upcoming deliberations on the potential effects of the administration's modifications to the U.S. export control system.

Results in Brief

To develop its defense cooperation initiatives, DOD largely relied on incomplete data and did not perform the analysis necessary to determine the underlying causes for problems it identified. Some of the initiatives addressed known problems, such as those that had been identified through efforts to modernize DOD's existing computer systems. However, for others DOD had very little data or analysis demonstrating the underlying problems and how best to resolve them. For example, the Department identified initiatives to reduce the time it takes to process export licenses. To streamline the process, DOD largely relied on data collected on the average processing time to develop timesaving initiatives, but it did not examine the reasons for lengthy processing time on particular cases. As a result, the initiatives to shorten the processing time may not address any underlying problems in the decision-making process. In addition, DOD justified its initiatives using examples of situations depicting problems with the export control system, but many of the examples were either not accurate or did not include information needed to understand the reasons the situation arose.

It is unclear whether DOD's initiatives will achieve the desired outcomes of improving U.S. and foreign forces ability to operate together in coalition warfare scenarios, reducing a gap in military capabilities between the United States and its allies, and ensuring that U.S. companies successfully

²*Defense Trade: Status of the Department of Defense's Initiatives on Defense Cooperation* (GAO/NSIAD-00-190R, July 19, 2000).

compete in overseas markets. DOD has not clearly demonstrated how its defense cooperation initiatives, for instance, will improve interoperability between U.S. and foreign forces. In fact, the after action report on the recent Kosovo coalition operation did not identify U.S. export controls, which were a major focus of the Department's initiatives, as a major impediment to interoperability. While the DOD's initiatives may help some companies share technology or successfully compete in overseas markets, they do not address many relevant factors that fall outside of the Department's sphere of influence and control. For example, national governments have traditionally tended to purchase major defense equipment from their domestic companies or when buying foreign products require domestic production as a condition of sale. A preference for domestic production appeared to influence a recent competition involving a European and a U.S. product. The European government selected the European product even though the U.S. government provided assurances that access to U.S. technology would not be inhibited.

The effects on desired outcomes of the administration's Defense Trade Security Initiative proposals remain uncertain. The Departments of State and Defense have not agreed on how to implement some proposals such as exempting exports to certain allies from licensing requirements. For example, the Departments have not agreed on criteria or parameters for assessing comparability of allied countries' export control regimes. Once the Departments agree, the administration will have to negotiate changes to the export control systems of the affected countries. In addition, the Departments of State and Defense have agreed in principle on the need to enhance computer interconnectivity between the departments but have not agreed on how best to accomplish this objective.

In commenting on a draft of this report, DOD disagreed with our findings because the Department believes it performed adequate analysis of the underlying problems. The State Department agreed with our critique of DOD's export control examples. However, the State Department disagreed with our characterization of the computer enhancement proposal because it believes that the Departments have already agreed that the implementation of the proposal is limited to improving communications and data exchange connectivity between the State Department and DOD. Because the Departments did not provide any additional supporting information, we did not revise our report.

Background

International defense cooperation has become increasingly important to governments and defense companies since the end of the Cold War. The U.S. government has identified international cooperation as a major part of its national security strategy for the 21st century since many security challenges can no longer be addressed by a single nation. Further, shrinking defense budgets and rapid technological changes have changed the current business environment for defense companies. Looking to replace declining domestic sales, defense companies have been motivated to seek cross-border industrial partnerships to gain access to each other's markets. However, companies and foreign customers are concerned about some U.S. government restrictions that they believe have impeded industry's ability to partner and cooperate internationally. DOD's identification of its initiatives was an attempt to improve conditions for cross-border defense cooperation.

DOD identified several outcomes it wants to achieve with its defense cooperation initiatives, including improving interoperability, reducing the military capabilities gap, and ensuring that U.S. defense companies successfully compete abroad. These desired outcomes are not new, but DOD leadership has determined that addressing them in a post-Cold War era requires greater cross-border defense industrial cooperation and increased interaction with U.S. allies. DOD officials recognize that promoting a global defense market presents both benefits (such as increased interaction with allies) and security risks (such as the loss of the U.S. technological edge or the potential spread of weapons). As a result, in 1998, DOD commissioned several studies on these benefits and risks, and in the following year formed a senior-level working group to identify initiatives to facilitate cross-border cooperation among defense companies while protecting U.S. security interests.

The working group compiled a list of 81 defense cooperation initiatives. Table 1 provides a summary of the initiatives and their overall objectives. Thirty-four of the initiatives were part of an ongoing effort to reinvent the Foreign Military Sales Program and have not been fully implemented. Forty-seven of the initiatives were intended to streamline processes and/or change policies in several areas, including export controls, release of classified information to foreign countries, procurement from domestic and foreign companies, and industrial security. DOD has completed implementing about one-third of its 47 initiatives, but the majority are ongoing, with no established timetable for completion.

Table 1: Summary of DOD's 81 Defense Cooperation Initiatives

Categories of initiatives and selected examples	Objectives
Thirteen Foreign Disclosure Initiatives, ^a such as <ul style="list-style-type: none"> • establishing guidelines for training in international security and disclosure and • initiating reviews to decrease time to approve foreign visits and/or access to classified information. 	To reduce the time associated with releasing classified information to foreign entities and to ensure that personnel have training and guidelines to release information only when it is appropriate and authorized.
Eleven Automation Initiatives such as <ul style="list-style-type: none"> • replacing several systems and databases, such as the Foreign Disclosure System Classified Military Information Database and the Technology Protection System Munitions Database and • developing a new computer system for the Departments of Defense, State, Commerce, and other federal agencies involved in the export control process. 	To facilitate expedited license processing; protect agency sensitive information; reduce repetitive submission of technical data; provide a standard user interface for the submission and review of supporting documentation; and comply with the Government Paperwork Elimination Act and the Clinger-Cohen Act.
Twelve Export Control Initiatives such as <ul style="list-style-type: none"> • developing a DOD plan to improve effectiveness of the export licensing review process, • expanding the International Traffic in Arms Regulations export licensing exemptions to other countries—similar to the historical exemption provided to Canada, and • establishing an ombudsman to give exporters an avenue to the licensing system. 	To improve the timeliness and quality of the export review process; facilitate cooperation with trusted allies by reducing burdens for obtaining export licenses; and assist industry by providing insight into the licensing process for foreign military sales and direct commercial sales.
Eight Defense Industrial Base Initiatives such as <ul style="list-style-type: none"> • concluding the Declaration of Principles with the United Kingdom, • documenting DOD's utilization of foreign sources, and • starting industrial base discussions with other countries. 	To improve the bilateral framework for cooperation and facilitate a more integrated industrial base; improve the quality of information on U.S. reliance on foreign sources; and identify common areas to improve cooperation.
Three Defense Industrial Security Initiatives such as <ul style="list-style-type: none"> • proposing changes to the National Industrial Security Program Operating Manual. 	To eliminate unnecessary requirements that do not enhance national security.
Thirty-four Foreign Military Sales Reinvention Initiatives such as <ul style="list-style-type: none"> • developing policies for U.S. government and industry cooperation and for Foreign Military Sales agreements, • adjusting Foreign Military Sales surcharges,^b and • reimbursing U.S. government for support of direct commercial sales and foreign military financing/direct commercial contracts. 	To establish a better working relationship between the U.S. government and industry to provide accurate information on requirements and pricing to meet customer's needs; provide foreign customers greater visibility and participation in the development of agreements; and increase U.S. government partnering with U.S. industry in the area of direct commercial sales opportunities.

^aThe disclosure initiatives cover the approval of foreign customers' visits and/or access to classified information.

^bSurcharges are authorized charges included in Foreign Military Sales agreements, which are calculated as a percentage of the basic cost of the item or service to recover costs that have been incurred by the U.S. government.

Source: GAO analysis of DOD initiatives.

DOD's defense cooperation initiatives prompted additional discussions on the U.S. export control system. In December 1999, the Departments of State and Defense established a new working group to develop proposals

to change the export control process. The State Department is responsible for controlling the export of defense items but refers export license applications to DOD and other agencies when technical or policy reviews are needed before making a licensing decision. By March 2000, the Departments of State and Defense had agreed to 15 proposals intended to streamline the export control process. The proposals ranged from improving the use of existing regulatory exemptions to creating new types of export licenses. The White House, the National Security Council, and the Department of Justice joined the discussions, and the parties reached final agreement on these and two additional proposals that were announced on May 24, 2000, as the Defense Trade Security Initiative.

DOD Selected Many of Its Initiatives Without Sufficiently Analyzing the Underlying Problems

To improve defense cooperation, DOD compiled a list of initiatives, 47 of which were intended to address problems with the Department's internal export control and procurement processes and policies. Although some initiatives were intended to correct deficiencies previously identified through audit reports, DOD proposed many of the 47 initiatives without first analyzing the reasons for the problems. For these initiatives, DOD had very little data or analysis demonstrating the underlying problems and how best to resolve them. In addition, DOD justified some of its initiatives using examples to demonstrate problems with the export control process. However, the information provided on the examples was often incomplete and in many cases, the reports on the incidents contained factual errors. Without a full understanding of the underlying problems, it is unclear whether DOD's initiatives will correct problems that may exist.

Some Initiatives Were Intended to Address Known Deficiencies, but Many Were Based on Limited Analysis of the Problems

Thirteen of the 47 initiatives were supported by audit recommendations or based on the need to modernize existing computer systems. For example, certain initiatives cited the need to establish training, guidance, and communication processes to improve efficiency within the export licensing process that DOD uses to provide technical reviews to the State Department. The Department of Defense Inspector General, in a 1999 audit report, identified deficiencies in these areas and recommended changes to address these problems. DOD identified other initiatives that were part of its ongoing modernization efforts to replace a variety of internal software programs or databases pertaining to classified information, export licenses, and foreign visits. For example, one of these databases had not been upgraded for about 20 years, and another required changes to make the system Y2K compliant.

The remaining 34 initiatives were largely based on limited data or analysis of the underlying problems. For example, 14 of DOD's initiatives to change the processes for controlling exports and release of classified data were consistent with recommendations in a white paper prepared by the Defense Security Cooperation Agency in 1999.³ The white paper, however, was largely based on concerns from customers and industry, and DOD did not verify the information provided or assess the basis for the concerns before undertaking the initiatives. In addition, a 1999 Defense Science Board report on globalization and security also contained recommendations consistent with 14 of DOD's initiatives.⁴ Some senior-level officials who worked on this report told us that limited empirical data existed to support the report's recommendations. When we examined the report's list of source documents, we found that 70 percent were taken from newspapers and periodicals; no original data were collected. Finally, the remaining initiatives were based on anecdotal evidence collected during meetings with allies and industry and from an informal survey of several major defense companies. However, DOD often did not validate whether the problems existed nor examine the underlying reasons for problems identified by allies and industry.

Without examining the underlying reasons for problems that may exist, DOD has no assurance that many of its initiatives will resolve the problems. For example, DOD has several initiatives intended to reduce lengthy license processing time by including time limits for reviewing licenses and reducing the number of review levels. In examining processing time, DOD collected data on the average time it takes to review export licenses. While reducing processing time is a worthy objective, concentrating on average time may obscure reasons for lengthy processing times on particular cases or obscure the factors that contributed to a speedy licensing decision. Data could be collected on the export control licensing process that may provide indications of where problems lie in the process. In fact, a recent law stated that the State Department should perform such a study and report to congressional committees on the munitions licensing process.⁵ Among

³The Defense Security Cooperation Agency (in cooperation with the Office of Policy Support within the Office of the Secretary of Defense and the Defense Threat Reduction Agency as well as industry organizations) prepared a white paper entitled *Arms Transfer/Technology Transfer White Paper* in 1999.

⁴Nine recommendations were found in both the white paper and the Defense Science Board report.

⁵P.L. 106-113, Nov. 29, 1999, sec. 1310.

other things, the Department's study is to analyze the processing time for each major category of licenses and include a breakdown of licenses by country. The State Department was to submit this report by the end of May 2000 but has not done so because of scarce resources and other demands, according to a senior State Department official. When the study is performed, it may contribute to an understanding of the reasons for various processing times.

Further, the Principal Deputy Under Secretary of Defense for Acquisition, Technology, and Logistics told us that while the average processing time has been reduced, it does not appear to be the fundamental problem with the U.S. export control process. This official said that the major problem is not the time it takes to review an export license application but rather that the outcome of the review process is often not satisfactory. In other words, when reviewing license applications for national security concerns, DOD officials may decide to deny the application or place terms and conditions on the application. Such conditions may be so stringent that they hinder the export of the defense article or service. Some senior officials from defense companies also told us that the rules governing license approvals are not consistently applied.

Many of DOD's Examples of Export Control Problems Lacked Key Information or Contained Factual Errors

To justify its export control-related initiatives, DOD prepared a list of 20 examples to illustrate situations where the export control process takes too long, is outdated, and hampers U.S. companies from competing abroad. DOD compiled the list from news sources, e-mails, congressional testimony by a U.S. company president, and company and embassy officials. Of the 20 examples, 6 pertained to comments made by or opinions expressed by foreign company and government officials about the U.S. export control process that did not involve an export license. In addition, one example involved a company and export license that DOD officials could not identify because the DOD official who provided the example did not specify the name of the company and has since left the Department.

Of the 13 examples where licensing information was available, several examples indicated inefficiencies in the export licensing process. Specifically, in one instance the State Department was slow in determining if it needed to notify Congress about an export, and in another instance an unexplained error in DOD and State Department records caused a delay in approving a license application. However, in 9 of 13 examples, DOD did not include information needed to understand the reasons that the situation arose or the examples contained factual errors. Appendix I provides DOD's

description and our analysis of 10 of DOD's examples. The remaining three examples are discussed below.

- One example, based on a company's press release, stated that a Singapore-based consortium (two-thirds owned by a Chinese affiliate) terminated its contract with a U.S. aerospace company because this company was unable to secure necessary U.S. export licenses in a timely manner. Under this contract, the U.S. company was to build a \$450 million satellite-based mobile telephone system. However, we found that the Department of Commerce—responsible for controlling the export of items with both civil and military applications—denied the U.S. company's license application. The Department, in consultation with other federal agencies, decided to deny the export application because of concerns of possible Chinese military involvement, questions about the company's dealings with China, and its hiring of a foreign national—the son of the Chinese general overseeing China's military satellite program. DOD's example indicates that lengthy processing time caused the company to lose the contract when, in fact, the company was denied the license because of concerns with the export.
- In a second example, based on an aviation publication, a U.S. company is still waiting for the State Department to complete a review of its Technical Assistance Agreement to build a Chinese communications satellite.⁶ According to DOD's example, the U.S. government approved the agreement (in February 1998) and then temporarily suspended it in December 1998 to make sure it was in compliance with new export regulations. However, we found that the State Department suspended the agreement principally because of an ongoing criminal investigation of the company. Section 1512 of the Strom Thurmond National Defense Authorization Act for Fiscal Year 1999 (P.L. 105-261, Oct. 17, 1998) requires the President to certify that any export to the People's Republic of China of missile equipment or technology will not be detrimental to the U.S. space launch industry or will not measurably improve the missile or space launch capabilities of the People's Republic of China. Since the company's agreement involved missile technology, the State Department was required to suspend the agreement to review the case for the purpose of such a certification. After the review, the State

⁶A Technical Assistance Agreement is an agreement for the performance of defense services or the release of technical data that is subject to the review and approval of the State Department.

Department determined that it was not prepared to recommend such a certification because the company was under grand jury investigation for possible export violations; consequently, the suspension remained. In June 1999, the company asked the State Department to lift the suspension. The State Department responded in August 1999 that the suspension should not be terminated, but it did not disclose the reason for its decision. However, 5 days later, a State Department spokesman publicly stated that the Department was concerned about the company being investigated for allegedly breaking export control laws. DOD's example indicates that the company had not received a response from the State Department when, in fact, the Department had completed the review and communicated the response to the company.

- A third example, based on a DOD e-mail, stated that in June 1999 a U.S. company could not perform inspection and repair work on aircraft purchased by the Royal Thai Navy under the Foreign Military Sales Program because the State Department required the company to first obtain a signed Technical Assistance Agreement, which the Royal Thai Navy refused to sign. The example stated that the State Department had not previously required a signed agreement for such work under its export control regulations. We found that the State Department had not changed its requirement. In fact, the State Department issued guidance in March 1997 to the contractors stating that a Technical Assistance Agreement is needed when providing defense services under a Foreign Military Sales agreement. In this particular case, the company had already obtained an approved agreement from the State Department in anticipation of this work. According to an e-mail sent by a DOD official in Thailand, the Royal Thai Navy refused to sign the agreement because it believed its contract was with the U.S. government and not the U.S. company. However, according to a company official, the Royal Thai Navy refused to sign the agreement because a DOD official advised against signing. Therefore, while DOD's example stated that the problem was a new State Department requirement for a Technical Assistance Agreement, in fact, the problem was a disagreement between the company and the Royal Thai Navy on the need for an agreement. DOD officials at the U.S. Embassy in Thailand sided with the Royal Thai Navy.

These examples demonstrate the complexities of the export control system and the need to understand the underlying reasons for problems that may exist. Without a full appreciation of the problem, it is unclear whether DOD's initiatives will resolve existing problems.

The Extent to Which DOD's Initiatives Will Achieve Desired Outcomes Is Unclear

DOD has several desired outcomes it wants to achieve from its defense cooperation initiatives, including (1) improving interoperability in coalition warfare scenarios, (2) reducing a gap in military capabilities between the United States and North Atlantic Treaty Organization allies, and (3) ensuring that U.S. defense companies successfully compete abroad. Senior DOD officials have stated that the defense cooperation initiatives are an approach to achieving these desired outcomes in addition to efforts under way with the North Atlantic Treaty Organization member nations. However, DOD has not clearly demonstrated how its initiatives will achieve these three outcomes, especially since other factors can influence these desired outcomes.

DOD has asserted that its initiatives will help achieve one of its desired outcomes—interoperability—but has not clearly demonstrated how these initiatives might result in this outcome. For example, regarding one recent conflict, the Kosovo/Operation Allied Force After-Action Report did not identify U.S. export controls as a major impediment.⁷ Instead, the report identified failures in communications and logistics and certain shortcomings in the Allies' capabilities as impediments to interoperability. The report also cited some concerns about the release of classified information to the allies and suggested the need to refine the policy and process for releasing such information. Although the report stated that the United States must carefully review its policy regarding licensing requirements for the allies, it provided no specific examples to support this suggestion. Further, officials responsible for supporting Kosovo operations from the U.S. European Command, as well as DOD and State Department arms transfer officials, told us that the U.S. export control system was not an impediment to interoperability in Kosovo. In fact, the State Department had established an expedited review process for export licenses designated to support the Kosovo operations. Additional resources were devoted to reviewing these export licenses, which were given priority over routine licenses that companies submitted. Also, some officials from major U.S. defense companies told us that DOD's export control initiatives are unlikely to help achieve interoperability because other factors may have a more direct impact on interoperability than DOD's initiatives.

⁷Kosovo/Operation Allied Force After-Action Report to Congress, DOD (Jan. 31, 2000).

DOD's initiatives may facilitate greater technology sharing between U.S. and European companies that, in turn, could affect the Department's second desired outcome of closing the transatlantic military and technology gap. Nonetheless, other factors, beyond DOD's influence, could more directly impact this outcome. For example, the Secretary General of the North Atlantic Treaty Organization and U.S. government officials have stated that European nations are not investing sufficient resources in developing military and technological capabilities and, in fact, European investment in defense research and development has been significantly below U.S. levels. According to some European officials, the gap in defense spending results from different spending priorities and different threat perceptions. In addition, whereas the United States has a global military threat and interest, European countries generally have focused on European security.⁸

Finally, DOD's initiatives may increase opportunities for some U.S. companies to compete in European and other overseas defense markets. However, like the United States, European countries tend to purchase major defense equipment from their domestic companies when such options exist. For example, in the United Kingdom's recent competition for the Beyond Visual Range Air to Air Missile, the U.K. government chose a European missile that is still in development over a U.S. product that DOD officials advocated was proven and less expensive. DOD also assured the U.K. government that access to U.S. technology would not be a problem. However, according to the U.K. Ministry of Defense, it selected the European option because it would provide superior military capability. Further, even when importing major weapon systems, many European countries have obtained benefits to their domestic economies by requiring subcontract awards to firms in their own countries.⁹

DOD's defense cooperation initiatives may encourage the formation of "global" defense alliances that can help achieve some of its desired outcomes, but this may not affect other countries' procurement decisions, policies, and practices. In addition, if defense budgets remain constant, defense companies will compete in a limited global defense market,

⁸NATO: *Implications of European Integration for Allies' Defense Spending* (GAO/NSIAD-99-185, June 30, 1999).

⁹For more information on this practice, see *Defense Trade: U.S. Contractors Employ Diverse Activities to Meet Offset Obligations* (GAO/NSIAD-99-35, Dec. 18, 1998).

thereby creating a situation where all companies may not be able to survive.

Effect of the Administration's Export Control Proposals Is Uncertain

On May 24, 2000, the administration unveiled 17 proposals to expedite and reform the U.S. export control system, which it characterized as the first major post-Cold War adjustment to the U.S. system. However, it is uncertain what effects the proposals will have. In a press statement, the State Department said that the proposals are intended to increase mutual security by (1) increasing interoperability, (2) enhancing defense capabilities, and (3) promoting transatlantic defense industrial cooperation and competition. As with DOD's cooperation initiatives, the administration has not demonstrated how its proposals will achieve these identified outcomes. Further, State Department officials told us that there was no analysis of existing problems. As a result, there is little assurance that the underlying problems with the U.S. export control system have been sufficiently analyzed to determine what the causes of the problems are and that the 17 proposals will remedy problems that may exist. Appendix II provides a description of the proposals, which are collectively known as the Defense Trade Security Initiative.

The effects of the proposals on desired outcomes cannot be assessed until the Departments of State and Defense issue regulations covering key proposals and gain some experience in their implementation. Some of the proposals call for fine-tuning regulatory procedures and practices and do not require significant changes to implement. However, the Departments have not agreed on the criteria or parameters for other proposals, such as granting exemptions to certain countries and/or foreign companies from export licensing requirements. The U.S. government has experience with exemptions of this nature, but according to the State Department, problems have arisen when the regulatory exemption was misused. Specifically, the U.S. government has long granted an export exemption enabling many controlled defense articles to be exported to Canada without licenses. However, the scope of that exemption was limited in

April 1999 because the State Department concluded that some companies misunderstood the exemption and unauthorized exports occurred.¹⁰

Under the new country exemption proposal, the administration envisions that the United Kingdom and Australia are the two countries most ready to take advantage of a broad export license exemption. The administration started discussions with the United Kingdom first. However, State Department and U.K. government officials told us that the United Kingdom's export system is not compatible with that of the United States in several areas. For example, U.S. export control laws require restrictions on other countries' ability to transfer U.S.-controlled defense articles to third countries. In contrast, according to these officials, the United Kingdom does not have the same restrictions. The U.S. and U.K. governments have yet to evaluate the compatibility of their export licensing systems and determine how enforcement concerns will be addressed. The negotiations may lead to a binding agreement between the United States and the United Kingdom. Once the agreement is reached, the details of the implementing regulatory language are key to avoiding misinterpretation of the exemption and possible abuses of the export control system.

The Departments of State and Defense also do not agree on how to implement another key proposal to establish an interagency computer system to exchange export license application information. Specifically, the two Departments have not established up-front what their needs are. DOD has allocated funds to establish an interagency database that would include interconnectivity not only with the State Department but also with industry, the Department of Commerce, and other federal agencies involved in the export licensing process. In contrast, the State Department would prefer a more limited scope whereby interconnectivity would be established between the Departments of State and Defense utilizing upgrades of existing systems.

Many decisions have to be reached and actions taken before the administration can implement some of its proposals. In making such decisions, a senior State Department official told news reporters in June 2000 that the State Department is likely to establish strict standards for

¹⁰On June 19, 2000, the U.S. and Canadian governments announced an agreement to strengthen their respective export control regimes. As part of this agreement, the Canadian government will introduce legislative and regulatory changes to strengthen certain defense export controls. The U.S. government, concurrent with these changes, intends to revise its regulations to reinstate most of the pre-April 1999 Canadian exemption.

implementing the proposals, which may take time. Senior DOD officials, however, have emphasized the importance of implementing the proposals in the near term. In addition, the administration has to determine if it will need to establish new monitoring or enforcement procedures to make certain that defense articles are properly controlled once exported. While the Departments are hiring additional staff, they will need to evaluate whether the new resources are sufficient once the proposals are fully implemented. Until such decisions are reached, it is uncertain how the U.S. export control system will change.

Conclusions

The administration, the U.S. defense industry, and foreign governments have expressed a high level of concern about current restrictions on cross-border cooperation. This level of concern indicates that the post-Cold War environment of declining defense budgets, multinational military operations, and rapid technological changes has created the need for a reexamination of U.S. defense trade and investment policies. Based on work done by DOD, the administration is moving forward to implement proposals to change the U.S. export control system. Without a clear and common understanding of perceived versus real problems and their underlying causes and without an appropriate analytical framework to tie changes to desired goals, it will be difficult to anticipate the outcomes of changes and to determine whether progress is being made. Such a situation will likely require subsequent reexamination.

Agency Comments

In written comments on a draft of this report, DOD stated that it disagreed with our findings, which it characterized as assumptions. Specifically, DOD said it did not develop its initiatives without first examining the underlying causes of the problems and did not rely exclusively on the export control examples cited in our report as support. According to DOD, many of its initiatives addressed problems raised by contractors and foreign governments. In addressing these complaints, DOD said it performed extensive analysis of the problems including the formation of a Rapid Improvement Team to examine the export license process. DOD also stated that the effects of the administration's export control proposals are not uncertain. According to DOD, it has achieved procedural improvements in its own export control process resulting in reduced license review times. DOD's comments are reprinted in appendix III. DOD also provided some technical comments, which we have incorporated as appropriate.

We agree that DOD relied on problems raised by contractors and foreign government officials to identify many of its initiatives. Although complaints are a means of identifying potential problems, they do not amount to a validation of the problems or an assessment of the underlying causes for problems that may exist. As stated in our report, some initiatives were intended to address known deficiencies such as those previously identified in audit reports, but many were based on limited analysis of problems identified in white papers, task force reports, and through discussions with industry and foreign government representatives. Moreover, the Rapid Improvement Team, which DOD established to reengineer the export control process, relied on corporate knowledge of its participants and did not focus on collecting and analyzing data to validate the problems they discussed. Finally, we examined the 20 export control cases provided by DOD and found that many did not contain information necessary to understand the situation or were inaccurate. DOD has used these examples on many occasions to support its initiatives, referring to them in speeches and congressional testimony. DOD did not provide any other examples to support its position. Because DOD has not provided additional information to support its initiatives, we see no need to revise our report.

While DOD states that the effects of the Defense Trade Security Initiative are not uncertain, it only provided reductions of the average license review times as an example of a known outcome. Although DOD has implemented initiatives to increase the timeliness of its review process, this represents only one aspect of a broad range of changes to modify the export control system. We acknowledge that there is value in reducing processing time. However, concentrating on average time may obscure the reasons associated with such time frames. As with many of DOD's initiatives, the administration's proposals are based on limited analysis of the underlying causes for existing problems. Therefore, there is no assurance that problems are going to be addressed by the proposed solutions. Further, decisions still have to be reached on how to implement proposals such as computer system improvements and the country licensing exemption. Until these decisions are reached, it is not possible to determine their effects. We see no reason to revise our report based on DOD's comments.

In written comments on a draft of this report, the State Department agreed with our assessment of DOD's export control examples and disagreed with our characterization of the status of the computer system improvements. For example, the State Department has indicated that it already has a modern computer system and has been working with the defense industry to electronically receive export license applications. While the

Departments of Defense and State have agreed in principle to a proposal to enhance U.S. government export license computer systems, our discussions with agency officials shows that the Departments have not agreed on the implementation of this initiative. DOD has requested funding to create a new interagency database to improve interconnectivity between industry; the Departments of Defense, State, and Commerce; and other federal agencies involved in the U.S. export control process. In contrast, the State Department has said that the proposal is limited to enhancing communications and data exchange connectivity between the State Department and DOD. At the time of our review, both Departments have been working separately with industry on prototypes for electronic license applications, which may result in some duplication of efforts or incompatible approaches. Therefore, we believe that the two Departments have different goals and expectations as to how to achieve computer interconnectivity during the export license review process. We revised our report to clarify the different positions held by the two Departments. The State Department's comments are reprinted in appendix IV, along with our evaluation of them. The State Department also provided technical comments, which we incorporated as appropriate.

Scope and Methodology

To determine the analysis and data DOD used to support its initiatives, we compared DOD's specific initiatives with recommendations presented in audit reports, studies, and white papers, and we evaluated the sources of information used to support the need for the initiatives. We discussed the extent of empirical data collected and analyses performed with key officials from industry, DOD, and the State Department involved in the studies and the initiatives. We examined DOD's examples of problems with the U.S. export control system by reviewing the export licenses and government technical assessments of the licenses and discussed the circumstances of each case with relevant industry, DOD, and State Department officials.

To determine the relationship between DOD's initiatives and desired outcomes, we reviewed DOD documents on global markets and international defense cooperation, including white papers, studies, speeches, congressional testimony, and DOD's initiatives. We also reviewed reports on interoperability and the European defense market to determine factors that could affect DOD's desired outcomes. We discussed the objectives of each initiative and the connection between the initiatives and desired outcomes with officials from 10 offices within the Office of the Secretary of Defense and with the Defense Threat Reduction Agency, the

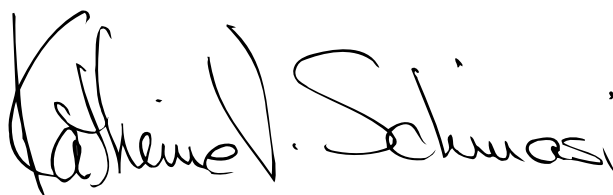
Defense Intelligence Agency, the Defense Security Cooperation Agency, the Defense Security Service, the Joint Chiefs of Staff, the military services, and the State Department.

To examine the potential outcomes of the administration's proposals that make up the Defense Trade Security Initiative, we reviewed position papers and other documents on the Initiative. We discussed the Initiative and its likely impact on the U.S. export control system with senior DOD and State officials involved in its development.

We performed our review from January through June 2000 in accordance with generally accepted government auditing standards.

As agreed with your offices, unless you publicly announce the contents of this report earlier, we plan no further distribution of this report until 30 days after its issue date. At that time, we will send copies of this letter to Representative Sam Gejdenson, Ranking Minority Member, House International Relations Committee and to Representative Ike Skelton, Ranking Minority Member, House Armed Services Committee. We are also sending copies to the Honorable William S. Cohen, Secretary of Defense; the Honorable Madeleine K. Albright, Secretary of State; and the Honorable Jacob J. Lew, Director, Office of Management and Budget. Copies will also be made available to others upon request.

Please contact me on (202) 512-4841 if you or your staff have questions concerning this report. Another contact and key contributors to this assignment are listed in appendix V.



Katherine V. Schinasi
Associate Director
Defense Acquisitions Issues

Examples of Export Control Problems

To justify the need for change to the export control system, the Department of Defense (DOD) prepared a list of examples of situations depicting problems with the system. Ten of these examples, pertaining to specific export licenses, are discussed in table 2 along with our analysis. We found that several of the examples indicated inefficiencies in the export licensing process but most contained factual errors or did not provide information needed to understand the reasons the situations arose.

Appendix I
Examples of Export Control Problems

Table 2: DOD's Export Control Examples and GAO's Analysis

DOD's export control examples	GAO's analysis
<p>1. A U.S. company waited 7 months for an export license to supply technical data to a Dutch company that was building components for a U.S. fighter engine. DOD characterized this example as demonstrating that the export control process is not suited to the current global environment.</p>	<p>This example demonstrates a problem of lengthy processing time. On September 21, 1998, a U.S. company submitted an export license application amending an existing coproduction agreement. The State Department approved the license application, valued at \$20 million, on July 16, 1999. The approval process took almost 10 months because the Department was late in determining if the Arms Export Control Act required notice to Congress about this export. The State Department determined that the dollar value of this amendment and the value of the basic agreement required congressional notification. Before the Department could notify Congress, it had to provide the license application to the Arms Control and Disarmament Agency for review. The Agency took 3 months to review and approve the export, thus delaying the notification process.</p>
<p>2. By the time a major U.S. electronics company received a State Department export license to bid on a contract to sell electronic modules worth more than \$50 million for European commercial satellites, the foreign spacecraft builder had turned to suppliers in Europe and Japan. DOD used this example to demonstrate that the export licensing process takes too long.</p>	<p>Although the example suggests that the U.S. company was unable to submit a bid, in fact the company bid on the contract and lost. The French spacecraft builder awarding the contract evaluated the competing companies using five performance categories. The builder rated the U.S. company poorly in one category because it perceived the U.S. export control system as possibly disrupting future supply. In the remaining four categories, the U.S. company was rated acceptable in three and outstanding in one. We do not know how the company's rating compared with other companies competing for the contract or what the final determining factor was in awarding the contract.</p>
<p>3. A U.S. company applied to the State Department for a license to send updated repair instructions for helicopter engines to Greece. The license took 5 months. DOD used this example to demonstrate that the export licensing process takes too long.</p>	<p>Processing of the license application was delayed pending the results of an investigation on the country receiving the export. The U.S. company submitted its export license application to the State Department on December 3, 1998, and it was approved on May 5, 1999. The license application took 5 months to approve because the State Department was delaying all munition exports to Greece in the spring of 1999 pending the conclusion of an investigation on whether Greece improperly transferred U.S. technology.</p>
<p>4. A U.S. company submitted license applications to send digital maps of Bosnia to the Netherlands for use in Dutch Chinook CH-47 helicopters supporting the United Nation's peacekeeping operations. The example stated that it took 3 months to process the license applications, despite the Dutch Embassy urging the State Department to expedite the applications due to the deteriorating situation in Kosovo. DOD used this example to demonstrate that the export licensing process takes too long.</p>	<p>According to State Department records, the license review process took 51 days, rather than 3 months as stated. In addition, the export license application did not indicate that the maps were intended for use in Kosovo. Therefore, according to a State Department official, the reason cited in the example for expediting the request—the Kosovo situation—had no bearing on the license request.</p>

Appendix I
Examples of Export Control Problems

(Continued From Previous Page)

DOD's export control examples	GAO's analysis
5. A U.S. company waited 3 months for a license to ship parts for British engines for a critical program for the United States. DOD used this example to demonstrate that the export licensing process takes too long.	Approval of the license application was delayed for an unknown reason. The U.S. company submitted its export license application to ship parts for the British engines for the Joint Strike Fighter Program on November 6, 1997. The State Department then referred the application to DOD for review. However, there was a discrepancy in the two Departments' records as to when DOD completed its review. DOD's records showed that it completed its review on December 22, 1997, but the State Department's records indicated that DOD completed its review on February 6, 1998. According to the Director of the State Department export licensing office, the State Department accesses the DOD computer licensing system every night to obtain DOD's final position on all export licenses for that day. However, this case, for some unknown reason, was not retrieved. As a result, the State Department did not approve the export license until February 11, 1998. The license would have been issued in 1-½ months rather than 3 months had the case been retrieved on the day that DOD completed its review. This example demonstrates inefficiencies in the export licensing review process.
6. A U.S. company license request to sell Air-Sea Rescue Flares to the Italian Coast Guard to rescue North Atlantic Treaty Organization airmen during the Kosovo crisis was turned down because the licensing officer did not think the application had enough detail. The flares had already been approved for sale to 30 countries, and the export to Italy was eventually approved. DOD used this example to demonstrate that the export control process does not reflect the real world situation.	The company's initial application was returned on January 14, 1999, because of missing information needed for the license review process. The company resubmitted its application on February 1, 1999, and the license was approved on April 13, 1999. The export license application stated that the flares were to be used for the certification and operational testing of the launcher for the ATR-42 aircraft; the application did not associate this export with the Kosovo crisis. In addition, the application referred to a prior export of the item about 8 years ago for which the State Department no longer has a record, but it did not indicate that the item had been approved for sale to 30 countries. According to the Director of the State Department export licensing office, such information is needed to facilitate the review of an export license application. The Department of Defense took almost 7 weeks to review this case because it had a backlog of export licensing cases and this license application did not identify an urgent requirement for turnaround, according to a DOD official.

Appendix I
Examples of Export Control Problems

(Continued From Previous Page)

DOD's export control examples	GAO's analysis
7. A U.S. company applied for an export license to ship modules containing focal plane arrays (a type of optical sensor) to Sweden. These modules were to be incorporated into cameras for civilian use by factories, power plants, and similar customers. For 4 years, the company applied for and obtained 6 export licenses from the Department of Commerce authorizing the export of 1,000 modules. (The Department of Commerce is responsible for reviewing and approving exports that have both civilian and military applications.) In November 1998, the U.S. company submitted another application to the Department of Commerce to export 200 modules. In January 1999, the Department of Defense, which was reviewing the license at the request of the Department of Commerce, asked the company for additional information. The company promptly submitted the requested information but received no reply from DOD. On May 12, 1999, the company's export application was returned without action but included instructions to apply for an export license at the State Department. DOD used this example to demonstrate that the export control process does not reflect the real world situation.	A pending determination of whether this export license application falls under the jurisdiction of the Department of Commerce or State Department delayed this case. At the time the U.S. company submitted its export application, the U.S. government was determining whether the type of modules were to be controlled as a dual-use item by the Department of Commerce or as a munition item by the State Department. DOD officials believed that these modules were a munitions item and, consequently, advised the Department of Commerce to return the export application to the company and direct the company to submit its application to the State Department. Subsequently in April 1999, the State Department determined that the modules should be controlled as a munitions item.
8. A U.S. company bid on a contract to sell gear knobs for use in a commercial airliner to a manufacturer in a North Atlantic Treaty Organization country. The U.S. company has had a license pending for months despite the fact that the knobs are in widespread commercial use. At the critical design review, the company was told that the knobs had to be covered by a shroud so the visiting foreign contractors could not see the product to be installed in their aircraft. DOD used this example to demonstrate that the export control process does not reflect the real world situation.	The approved export license did not contain the restrictions cited in DOD's example. The U.S. company's initial export application was submitted on January 12, 1999, and was returned on January 22, 1999, because it lacked sufficient documentation for information needed during the licensing review process, such as specification of the end user and end-use of the export. The U.S. company resubmitted its application on March 11, 1999, and the license was issued on July 13, 1999. The approved license did not contain any restriction on shrouding the knob during the critical design review. The company is required to abide only by those restrictions stated on the approved license.

Appendix I
Examples of Export Control Problems

(Continued From Previous Page)

DOD's export control examples	GAO's analysis
<p>9. In September 1999, a U.S. company was preparing the GE-4 commercial satellite for launch in French Guiana scheduled for late November. During final checkout prior to shipment, a failure occurred with one of the traveling wave tubes made by a German company. To determine the cause of the tube's failure and remove the technical lien from the spacecraft, the U.S. company submitted a license for the traveling wave tube to the State Department on June 2, 1999. The State Department rejected the license application as being too broad. The tube had to be licensed for reexport to the company in Germany for repair and/or replacement before the satellite could be retested with the repaired tubes. The license application was resubmitted on September 15, 1999, to the State Department. It was approved on October 6, 1999 (21 days later). The license processing time almost caused a shipping delay for the repaired satellite and thus was close to causing a launch slip and, consequently, steep financial penalties for the company. Since the company already had authority to buy and install this commercial satellite component, company officials thought it seemed excessive to get an additional license for this activity. DOD used this example to demonstrate that the export control process does not reflect the real world situation.</p>	<p>The U.S. company did not use options available to it for export components with high failure rates. The U.S. company submitted its initial application on May 25, 1999, which the State Department received on June 3, 1999. The export license application was for 400 traveling wave tubes destined for France, Germany, and Japan. A State Department licensing officer called the U.S. company to discuss the case. Subsequently on July 19, 1999, the State Department returned the application and asked the U.S. company to submit a new license application with additional information and clarifications. The U.S. company resubmitted its application on September 13, 1999, for two traveling wave tubes destined for Germany with an urgent requirement to approve by September 23, 1999, in support of GE-4 satellite. The application was approved on October 6, 1999. The Director of the State Department export licensing office stated that the U.S. company should have used the temporary licenses available under the export regulations, which are commonly used by other companies.</p>
<p>10. In October 1998, a U.S. company submitted a license application to the State Department to enable it to compete on the United Kingdom's Future Strategic Tanker Aircraft project. The company's intent was to compete its aircraft as a possible candidate to replace the United Kingdom's aging fleet of VC10 and TriStar aircraft. The company had also received notice that a European company would be proposing its aircraft in the competition. Because it had not received any feedback from the U.S. government, the U.S. company resubmitted its export license application in April 1999. Both the Departments of State and Defense delayed the license approval, preventing the U.S. company from participating in the U.K. competition until significant high-level intervention brought this case to light. DOD used this example to demonstrate that the export control process does not reflect the real world situation.</p>	<p>The U.S. company submitted its initial application on November 3, 1998. The State Department returned the application on March 29, 1999, because it was concerned that commercial entities were involved as end-users in the case. Specifically, the tanker aircraft were to be owned and operated by commercial entities as cargo planes and leased to the United Kingdom part-time as strategic tankers—an unusual arrangement raising licensing policy questions. The State Department licensing officer informed the U.S. company about its concerns and asked the company to submit a new application and include more details about the roles of the commercial entities in the project. The U.S. company resubmitted its application on May 5, 1999. After discussing its concerns with officials of the Embassy of the United Kingdom in Washington, the State Department approved the license application with conditions on August 16, 1999. The Director of the State Department export licensing office stated that DOD, unlike the State Department, was not concerned about the commercial entities and approved the case in 3 weeks without placing any conditions or restrictions on the export.</p>

The Defense Trade Security Initiative

In May 2000, the administration agreed to these 17 proposals as part of its Defense Trade Security Initiative.

1. Major Program License: Create a single comprehensive export license for hardware, technical data, and defense services issued at the beginning of a project where the U.S. firm is the prime contractor.
2. Major Project License: Create a single comprehensive license for a direct commercial sale of defense articles by a U.S. prime contractor to North Atlantic Treaty Organization member states, Japan, and Australia.
3. Global Project License: Create a single comprehensive license to cover all exports occurring under a government-to-government international agreement for a cooperative project.
4. Technical Data Exports for Acquisitions, Teaming Arrangements, Mergers, Joint Ventures, and Similar Arrangements: Develop a single comprehensive export authorization to permit qualified U.S. defense companies to exchange broad ranging technical data for a variety of business arrangements with qualified foreign firms from North Atlantic Treaty Organization members, Japan, or Australia.
5. Enhance the Use of Multiple Destination Licenses: Increase the use of an existing license to permit U.S. firms to market specific products to designated users for a specified purpose.
6. Enhance the Use of Overseas Warehousing Agreements: Increase the use of overseas warehousing and distribution agreements that permit U.S. firms to export large numbers of items (such as spare parts) to a foreign company.
7. Expedited License Review for North Atlantic Treaty Organization Allies: Expedite U.S. government review of export licenses for Defense Capabilities Initiative projects or programs.
8. Special Embassy Licensing Program: Expedite U.S. government review of licenses submitted by the governments of the North Atlantic Treaty Organization countries, Japan, and Australia via their embassies in Washington, D.C., for end use by the requesting government.
9. Interagency Export License Electronic Control Process: Enhance computer connectivity between the Departments of Defense and State to

permit greater and more timely exchange of data on export license applications.

10. Extension of International Traffic in Arms Regulations Exemption to Qualified Countries: Extend a licensing exemption to countries that share with the United States congruent and reciprocal policies in export controls, industrial security, intelligence, law enforcement, and market access. This exemption would be limited to unclassified exports to a foreign government and companies that are identified as reliable by the U.S. government in consultation with the foreign government.

11. Defense Services Exemptions for Maintenance and Related Training: Create a new regulatory exemption for increased levels of maintenance services and training for North Atlantic Treaty Organization countries, Japan, and Australia.

12. Exemption for Department of Defense Bid Proposals: Permit U.S. firms to export certain technical data and services in support of DOD bid proposals without a license.

13. More Effective Use of Existing International Traffic in Arms Regulations Exemptions by the Department of Defense: Clarify the Department's use of existing regulatory exemptions that are available to it.

14. Streamlined Licensing for Commercial Satellite Components and Technical Data: Streamline the licensing process for parts and minor components and limited technical data needed to bid on projects and respond to insurance requests on commercial satellites.

15. International Traffic in Arms Regulations Exemption for Foreign Military Sales Defense Services: Permit the license-free export of technical data and defense services if they are expressly authorized in a Foreign Military Sales agreement and in the associated contract with a U.S. company.

16. Advance Retransfer Consent for Items Sold or Granted by the U.S. Government: Permit the retransfer of unclassified defense articles (valued under \$7 million) previously sold or granted by the U.S. government if the articles are to be transferred only between the governments of North Atlantic Treaty Organization countries, Japan, or Australia that signed advance blanket retransfer assurances.

17. Review and Revise the U.S. Munitions List of Controlled Defense Articles and Services: Establish a process for reviewing portions of the U.S. Munitions List on an annual basis so that the entire list is reviewed over a 4-year period.

Comments From the Department of Defense



ACQUISITION AND
TECHNOLOGY

OFFICE OF THE UNDER SECRETARY OF DEFENSE

3000 DEFENSE PENTAGON
WASHINGTON DC 20301-3000

AUG 16 2000

Ms. Katherine V. Schinasi
Associate Director
Defense Acquisitions Issues
National Security and International Affairs Division
U.S. General Accounting Office
Washington, DC 20548

Dear Ms. Schinasi:

The Department of Defense (DoD) disagrees with GAO's assumptions in the draft report, 'DEFENSE TRADE: Outcome of Recent Administration Initiatives is Uncertain,' dated July 19, 2000 (GAO Code 707524/OSD Case 2050).

The defense cooperation initiatives are one of a series of important efforts that the Department has underway to promote interoperability with coalition allies, promote trans-Atlantic defense industrial linkages, and enhance our security vis-à-vis potential adversaries.

The Department did not develop the initiatives without first examining the underlying causes for the problems. In fact, many of the initiatives addressed problems brought to our attention by contractors and foreign governments; e.g., export licenses. The complaints highlighted inefficiencies within our process, which when addressed would increase our ability to achieve the goals stated above. The Department conducted extensive analysis of many of the problems in order to develop appropriate solutions. The process included, among other things, a Rapid Improvement Team whose mandate was to examine the DoD export license review process, and a Defense Science Board "Globalization" Task Force, which included representatives from the Defense Department, academia, industry and former representatives from the State Department.

The DoD did not rely exclusively on certain examples it cites. The initiatives were based on a broad analysis of the pertinent circumstances -- not simply the illustrative examples in question, based on input from various sources, including industry, outside experts, internal DoD Components, and foreign governments.

We do not agree that the effect of the Administration's export control proposals is uncertain. In fact, on the procedural side, our efforts within DoD have already borne fruit. For example, we have achieved significant reductions in the amount of time it takes for the Department to complete its internal license review-down to about 20 days from over 46 days last fall.

Detailed technical comments have been provided separately and are attached for your reference, that further clarify the DoD position.

Sincerely,

Jeffery P. Draleo
Deputy Under Secretary of Defense
(Industrial Affairs)



Comments From the Department of State

Note: GAO comments supplementing those in the report text appear at the end of this appendix.



United States Department of State

Chief Financial Officer

Washington, D.C. 20520-7427

August 9, 2000

Dear Mr. Hinton:

We appreciate the opportunity to review your draft report, "DEFENSE TRADE: Outcome of Recent Administration Initiatives is Uncertain," GAO/NSIAD-00-191, GAO Job Code 707524.

The Department of State comments are enclosed for incorporation as an appendix to the final report. Technical changes were provided to your staff for incorporation as appropriate.

If you have any questions concerning this response, please contact Mr. William Lowel, Office of Defense Trade Controls, Bureau of Political-Military Affairs, at (202) 663-2861.

Sincerely,

A handwritten signature in cursive script that reads "Bert Edwards".

Bert T. Edwards

Enclosure:

As stated.

cc:

GAO/NSIAD – Mr. Denomme
State/PM/PPA – Mr. Maggi
PM/DTC – Mr. Lowel

Mr. Henry L. Hinton, Jr.,
Assistant Comptroller General,
National Security and International Affairs,
U.S. General Accounting Office.

Department of State Comments on GAO Draft Report
"Defense Trade: Outcome of Recent Administration
Initiatives is Uncertain"

Now on p. 4.

Introduction (p. 3)

See comment 1.

- We suggest the final sentence prior to "Results in Brief" be rephrased to read as follows: "Because the Administration's Defense Trade Security Initiative was also in response to industry and foreign government concerns, we are also providing information for you to use in upcoming deliberations on the potential effects of the initiatives."

Now on pp. 9-10.

Study of Processing Times (pp. 8-9)

See comment 2.

- Section 1310 of the Foreign Relations Authorization Act for Fiscal Years 2000 and 2001 recommends, but does not require, that the State Department provide SFRC and HIRC with a study to include four elements: (1) an analysis of license typology for calendar year 1999; (2) a review of current computer capabilities, including electronic links with other agencies; (3) an analysis of the workload and salary structure of the Office of Defense Trade Controls (ODTC) as compared to comparable positions at Defense and Commerce; and (4) any suggestions of the State Department relating to resources, regulations and statutes that might expedite licensing consistent with the objectives of the Arms Export Control Act.
- The Department fully intends to provide SFRC and HIRC with a study addressing all of these elements, but has deferred doing so pending the completion of statutorily mandated activities and reports, which must take precedence.

Now on pp. 10-12 and
appendix I.

DOD's Examples of Export Control Problems (pp. 9-11 and Appendix 1)

- We welcome GAO's independent critiquing of the twenty examples presented by DOD (out of more than 90,000 individual authorizations considered by ODTC in the two year period) of purported problems with State Department export controls -- and, in particular, the absence of any implications for allied operations in Kosovo (for which purpose ODTC licensing officers logged approximately 1,000 hours on the State Department Kosovo Task Force over and above normal duty hours).

- Indeed, prominent examples cited by DOD and addressed in the draft report (proposed satellite exports related to the People's Republic of China that are involved in ongoing investigations of improper conduct by U.S. aerospace firms) are not relevant to coalition war fighting or procedural matters; they involved senior-level policy decisions with which DOD's official positions have been in full consonance with those of the State Department.
- Similarly, we welcome GAO's conclusion in Appendix 1 that a proposed export of air-sea flares to the Italian Coast Guard - an example often cited in press interviews by DOD -- had no association with Kosovo operations and, in any case, appears to have languished in DOD for seven weeks.

Computers (pp. 15-16)

- The report reflects a misunderstanding of what has been agreed upon, and what remains to be done. As announced by the Secretary of State at the NATO Ministerial Meeting in Florence, the agreed initiative is to enhance communications and data exchange connectivity between State and DOD.
- The Department of State (ODTC) has had for several years a modern ADP system that is designed and operated to advance a wide range of registration, electronic licensing, compliance, enforcement, end use verification, UNSC and other embargoes, and other duties and responsibilities of the Secretary of State established in the Foreign Assistance Act, the Arms Export Control Act and related legislation, and/or the International Traffic in Arms Regulations. The State Department carries-out these various functions in consultation with various agencies, such as Treasury (U.S. Customs Service), Justice and the intelligence community.
- In addition, a minority portion of the licensing function is carried-out in consultation with DOD, in which approximately 25 percent of 45,000 licenses reviewed by ODTC each year are referred to DOD (as well as to other agencies and State bureaus) for advice. It is this discrete area that is the subject of inter-agency agreement and that agreement is centered around the following specific activities:
 - ODTC has for several years received export license applications electronically from the U.S. defense industry

Now on p. 16.

through a program that has evolved to the point where about 50 percent (22,000) licenses were submitted electronically in FY 1999. Licenses may be submitted through ODTC's Internet Web Site or through a private line server, offering end-to-end encryption. With the amendment to the ITAR effective July 1, 2000 concerning electronic submission of satellite-related export authorization requests to U.S. allies, ODTC has already established the capability for submission of technical data in electronic media (i.e., PDF file format) along with the license submission, and DOD is committed to establishing a link with DTC by which it can receive this information electronically as well as licenses that ODTC may refer to DOD related to two DTISI initiatives: the Defense Cooperation Initiative and the Special Embassy Program.

- Similarly, DOD has committed to re-establish a communications link with ODTC by which it will communicate its positions on individual license applications electronically (rather than by paper).
- Further, ODTC has been engaged throughout 1999 and 2000 in conjunction with U.S. defense firms in a program of expanding its electronic licensing function to include, inter alia: (1) a pilot program for the submission of technical assistance agreements and manufacturing license agreements and related technical data, for which purpose DOD's ability to receive electronic submissions from ODTC will also be utilized; and (2) reporting by U.S. defense industry of all shipments from the United States of defense articles and defense services, as required by a recent amendment to the Arms Export Control Act.
- Therefore, independent of the DTISI initiative, which concerns enhanced connectivity between State and Defense, State already has a modern ADP system and has been moving towards fully electronic submissions from U.S. industry for several years. DOD intends to overhaul its internal computer system, in part to ensure it is in a position to communicate electronically with State's established system and in part to establish similar links between DOD and Commerce.

The following are GAO's comments on the State Department's letter dated August 9, 2000.

GAO Comments

1. We have modified the text of the report to address this comment.
2. The law states that the State Department should provide the Senate Foreign Relations Committee and the House International Relations Committee with a study examining the munitions licensing process, including the time it takes to review various licenses. The State Department recognizes that it is expected to perform such a study, but it did not meet the statutory time frame because of other commitments. As we stated in the report, this study may contribute to an understanding of the reasons for various processing times. We encourage the State Department to fulfill its intentions of providing the congressional committees with this study.

GAO Contacts and Staff Acknowledgments

GAO Contact

Thomas J. Denomme (202) 512-4287

Acknowledgments

In addition to the name above, Anne-Marie Lasowski, Marion Gatling, Lillian I. Slodkowski, John Ting, and John Van Schaik also made significant contributions to this report.

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