Chapter 5

AN ASSESSMENT OF U.S. NATIONAL SECURITY EXPORT CONTROLS

INTRODUCTION

U.S. policy on national security export controls should result from a process that weighs the benefits of controls to the United States in its relations with adversaries against the costs of controls in relations with allies and trading partners. The purpose of controls is to prevent or delay improvements in Warsaw Pact military capabilities that can be accomplished through the acquisition and use of Western technology and goods. Military capabilities can be enhanced directly, through better weapons performance, or indirectly, through improved capability to manufacture military equipment. In peacetime, the United States and its allies can counter such advances by the Soviet bloc, albeit by incurring higher military expenditures that impose additional

costs on Western economies. The benefits of controls, therefore, are measured by the degree to which Soviet military advances are prevented or delayed and the extent to which savings to the West are realized.

The adverse effects of controls are harder to measure because they derive primarily from a complex web of competitive and cooperative relationships among Western countries. Of principal concern are the sales and market share that U.S. producers of goods and technologies may lose or forego as a result of how the U.S. control system is designed and administered and how it compares with the control systems of other countries with competitive suppliers. Reduced revenue may translate into less investment, a lower growth rate, and reduced innovation, the effects of which could be important to the military as well as the commercial sector. To the extent that private firms anticipate that controls will have an adverse effect on their ability to exploit new technologies, innovation may be directly discouraged. Export controls can also cause friction between the United States and its allies and may interfere with their collaboration on technology security; on weapons development, production, and standardization; or on other matters bearing directly on East-West relations.

The advantages to the West of controlling technology transfers to the East are not simply strategic; controls may yield savings in Western defense expenditures that could be devoted to nonmilitary uses, including private investment. Similarly, the costs of controls are not strictly commercial; they, too, have implications for the military balance of power as well as for East-West competition in nonmilitary spheres. Thus, assessing U.S. export controls solely in terms of military security gains versus commercial costs is inappropriate because the basis of comparison is incomplete.

It follows that a strictly quantitative benefit-cost assessment of export controls is not feasible. Not all, perhaps not even the most important, advantages and disadvantages of controls can be precisely quantified or compared. They derive from a rapidly changing context and rest on qualitative judgments. The panel affirms that there is a compelling justification for national security export controls. Nevertheless, certain features of the control system impose excessive costs or have little effectiveness. In these cases, it is the panel's judgment that changes in the control system are warranted.

This chapter addresses three basic questions. First, how effective are U.S. national security export controls in denying or delaying Soviet acquisitions of Western dual use technology? Second, how efficiently are they administered? And third, what costs to the economy and the research enterprise are associated with current controls and their administration? Because knowledge about the effects of controls on commercial markets as well as on national security will never be complete, and because judgments will be affected by changes in East-West relations, economic conditions, and technology, this chapter also addresses a fourth, procedural issue: Is the current U.S. policy process capable of generating adequate information, weighing the competing considerations, and balancing U.S. interests over the long term during which it will be necessary to maintain some type of export control system?

Detailed answers to these questions have eluded previous assessments of the export control system. Not only are the effectiveness and costs of controls uncertain, but there is a dearth of reliable data even on such basic points of reference as the value, composition, and share of U.S. export trade affected by national security export controls.

The Department of Commerce, for example, publishes aggregate figures for individual validated license (IVL) applications--the total number of applications and their total value. It compiles but does not publish breakdowns of the number and value of IVL applications by control list category (ECCN). But the department's published or prepared data do not distinguish between items controlled for national security reasons and those controlled for foreign policy, nuclear nonproliferation, or other reasons; nor do they distinguish between applications for exports and those for reexports. The department does not examine individual licenses that are returned after use to determine what proportion of the value of goods authorized for export was actually shipped. Nor does the department routinely obtain from qualified exporters or other government sources (e.g., the Bureau of the Census) reports on the volume and value of transactions made under bulk licenses.

Furthermore, the Commerce Department data base does not provide the percentages of reexport applications that are submitted by U.S.-headquartered and independent foreign-based companies, even though reexport approval requirements, especially as they affect independent foreign manufacturers

and distributors, are a highly controversial feature of the U.S. export control system, both in the United States and abroad. Perhaps most importantly, there is no correspondence between control list categories and the product statistical classifications under which exports are reported to and by the government--a linkage essential to any quantitative analysis of the effects of controls on U.S. export performance.

As a result of congressional and business community pressures to increase the speed of individual licensing decisions, data are available on the processing of IVLs. Although this information is useful, Commerce Department officials have otherwise received little encouragement and few resources to analyze the scope and consequences of their activities. This information deficit impedes informed policymaking and efficient administration as much as it does independent evaluation. The panel attaches high priority to correcting these deficiencies.

In making its own assessment of the operation and effects of export controls, the panel took a variety of steps to fill the information void. In addition to the briefings presented

by government officials and business representatives and its study missions to Western Europe and Asia, the panel commissioned two types of studies, each with several components.

First, the panel requested and was granted a "national interest" exception under Section 12(c) of the Export Administration Act, permitting its consultants unprecedented access to Commerce Department license files and data bases, subject to strict observance of the confidentiality of business information. The consultants' study included analyses of a randomly selected sample of recently approved individual license applications; a random sample of license applications returned without action; a sample of reexport authorization applications submitted during a recent period; and more than half of the license applications, categorized by administrative criteria corresponding to levels of military criticality, for which processing was completed in a recent one-week period.

Second, the panel commissioned two surveys of U.S.-based companies affected by national security export controls. The first survey focused primarily on experience in applying for

and using individual validated licenses. The second survey was designed to ascertain how the distribution license is used and what have been the effects of recent changes in the Export Administration Regulations governing such licenses.

The conclusions and judgments reached by the panel following these fact-finding efforts are discussed below.

EFFECTIVENESS OF NATIONAL SECURITY EXPORT CONTROLS

Intelligence and Enforcement Evidence

Direct evidence of the effectiveness of national security controls is confined to the results of enforcement activities and fragmentary intelligence data (see Chapter 2). The former presents a mixed but narrow picture from which only tentative conclusions can be drawn. Some investigations, as in the VAX case, have documented the elaborate, unpredictable, and presumably costly lengths to which the Soviets have gone in the pursuit of certain embargoed items; but other cases suggest that the scale and complexity of international marketing and distribution activities afford ample opportunities to evade controls.

Intelligence sources estimate that the Soviets are paying twice the market price or more to obtain dual use technology illegally, which suggests that controls are raising the cost to the Soviets of their reliance on Western sources. By the Soviets' own estimate, however, contained in the Farewell documents obtained by French intelligence, 70 percent of the Western items that they target and succeed in acquiring are subject to some form of national security export control. The proportion was the same during the most recent Soviet five-year economic plan (1981-1985) as it was in the previous five years (1976-1980), a period of relatively looser Western controls.[1] On the other hand, according to the same sources, the Soviets fulfill only about one-third of their requirements annually, suggesting that they encounter some delays in obtaining what they want when they want it.[2] The extent to which such delays have, in turn, delayed Soviet deployments of advanced military equipment is not known.

It is reasonable to surmise on the basis of this limited evidence that the control system, relative to a free market, inhibits and raises the cost but rarely foils completely technology acquisition efforts as sophisticated and well-financed as those mounted by the Soviet Union.

Nevertheless, the question of which controls are relatively more or less effective remains unanswered.

Compliance

An indirect indicator of the effectiveness of controls is the level of corporate compliance. Although this level cannot be determined precisely, there is substantial evidence that compliance has increased in recent years as the government has committed more resources to enforcement. Between 1981 and 1985, the number of IVL applications increased more than 70 percent (from 71,369 to 122,606), exceeding the rate of increase in U.S. high-technology exports. Interviews conducted for the panel confirm what has been widely suspected. For years, many small exporters had been doing business unaware that their products required validated licenses. Directly and as a result of the publicity surrounding it, the U.S. Customs Service's Operation Exodus, which resulted in the seizure or detainment of numerous shipments lacking proper authorization, brought about a greater awareness of the Export Administration Regulations and thus a significant improvement in formal compliance. The enforcement campaign may or may not have reduced the number of intentional diversions.

Meanwhile, reexport license applications received by the Department of Commerce increased at an even faster rate, nearly doubling between FY1983 and FY1985. In this case, however, the increase in compliance has been one-sided. The overwhelming majority (about 90 percent by value) of reexport applications are from U.S.-headquartered companies and their foreign affiliates, a rate double or triple the estimated share (30 to 40 percent) of U.S. exports represented by intrafirm trade. Unrelated foreign firms initiate only 10 percent of reexport authorizations.

The disparity in the shares of reexport authorization applications of U.S. affiliates and foreign-owned firms is greatest in the case of CoCom member countries, which are the source of more than 80 percent (more than 90 percent by value) of all reexport applications. In a representative sample of recent applications from three major CoCom trading partners, between 87 percent and 98 percent of the submissions were traced to U.S. affiliates. The data strongly suggest that independent foreign companies are either ignorant of or casual in their compliance with U.S. reexport controls--except in the few countries, such as Switzerland, that require their firms to follow the rules of the country of origin when exporting imported products.

These findings are not surprising in view of the fact that most CoCom countries, for reasons of national sovereignty, refuse to cooperate in the enforcement of U.S. reexport controls and are prepared to resist any systematic effort by the United States to penalize noncomplying foreign companies. Of course, the export of all but unilaterally controlled U.S.-origin items to proscribed destinations from CoCom countries is subject to licensing by other governments. In these cases, U.S. reexport requirements are not only problematic but also redundant.

Discrimination in Licensing and Enforcement

In addition to the level of formal compliance, the effectiveness of export controls depends on the government's allocation of resources and effort in licensing and enforcement. Controlled products and technologies are of varying military significance, and countries and customers are of varying reliability in preventing their diversion to the Soviet bloc. It follows that exports of the most critical technologies and exports to countries with no or ineffective controls should receive the most scrutiny.

Discrimination, or the lack of it, is a function both of how much is swept into the control system and how it is treated. In the first instance, the panel estimates that a very large percentage of U.S. exports--as much as one-half of all nonmilitary manufactured goods shipped in 1985--is covered by one or another type of validated license.* Because exports that the Department of Commerce considers "high technology" constitute about two-fifths of U.S. manufactured exports, it is apparent that controls extend to products embodying relatively low technology.

The panel analyzed a sample of licenses for goods classified by level of military criticality, using current CoCom and U.S. government criteria.** The analysis showed

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* See pp. 5-31 to 5-32 for a detailed explanation of this estimate.

** The analysis was of a sample of 1,618 processed license applications categorized by Department of Commerce license officers. In each case, the officer identified, independent of the intended destination, the item being exported as either within the Administrative Exception Note 9 level, within the China green zone, eligible for shipment under a distribution license, or ineligible for shipment under a distribution license. The first three of these categories are step-wise inclusive rather than mutually exclusive. The four categories represent progressively higher levels of military criticality.

that the broad control net is heavily weighted with transactions in less sensitive items with allied and other friendly Western countries. Ninety percent of license applications are for exports to Free World countries. One-third of these applications are for items that may be exported to CoCom countries under a general license and even to Soviet bloc destinations without prior CoCom approval. According to the sample, the United States rarely refuses a license to export these so-called "national discretion" items to any destination, including the Eastern bloc. Two-thirds of the individual license applications were for items sufficiently lacking in military importance that they can be shipped from any CoCom country to the People's Republic of China without prior CoCom approval.

The large volume of cases involving exports of less critical items to friendly countries severely limits the degree to which licensing officials are able to focus their efforts on the most critical items. Nevertheless, in 1985 there were two major attempts to sharpen that focus, primarily with respect to country destinations. First, as discussed in Chapter 4, the Export Administration Amendments Act authorized the export of Note 9-level items to CoCom

countries under a general license (G-COM). Although this afforded some relief, the anticipated 15-percent reduction in IVL applications has yet to be realized, evidently because of ignorance or caution on the part of some exporters.* Second, President Reagan directed the Department of Defense, concurrently with the Commerce Department, to review license applications for selected products to 15 Western countries that are not parties to multilateral control agreements and that are regarded as potential points of diversion. This greater attention to so-called "third countries" is reflected in longer processing times and slightly higher denial rates than for exports to CoCom destinations, although it entails an additional layer of review whose independent contribution to the quality of the review process has been questioned by the General Accounting Office.[3]

Although more sensitive technology items are excluded from distribution license coverage, the panel found little evidence that, in the individual licensing process, more attention is devoted to products of greater strategic importance than to those of less importance. License

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* See page 5-22 below.

processing times for applications to Free World destinations do not vary significantly among categories that the Export Administration Regulations treat as more or less militarily critical. Similarly, on the panel's study missions to Europe and Asia, panel members heard frequent complaints from U.S. and foreign enforcement officials that, on direction from Washington, they devote much of their effort to seeking out diversions of low-technology, widely available products--instead of concentrating on goods of more strategic importance. One foreign-based U.S. Customs officer commented, "We spend most of our time chasing after PCs (personal computers)." The evidence strongly suggests that a greater focusing of efforts could enhance the effectiveness of the control system.

Benefits of Controls

A 1985 study sponsored by the Department of Defense[4] is the only major attempt to date to quantify the benefits of export controls. Using a small, carefully selected sample consisting mainly of rejected 1983-1984 license applications for exports directly to the Soviet bloc, the study estimated that the Soviets could have saved $0.5 billion to $1 billion a year over a 13-year period if the applications had been

approved and the acquired technology exploited. Under the same assumptions, the study projected additional U.S. and NATO defense expenditures of roughly the same magnitude to counter the improved Soviet capabilities.

These conclusions are based on 79 cases (from a universe of 2,000 applications) that were judged by a panel of military and technical experts to involve militarily "important," state-of-the-art technology with high reverse engineering potential. In other words, these 79 rejected applications represent the type of control, on exports directly to Warsaw Pact countries of highly sensitive dual use items, whose effectiveness and cost are least likely to be questioned. These cases further suggest that most of the benefits of controls, if they can be realized, are probably concentrated in a relatively narrow range of products and technologies.

Otherwise, the study's conclusions provide little policy guidance. The claimed benefits of controls are hypothetical in several respects. No attempt was made to determine whether the Soviets did or could acquire the technologies by other means nor to determine if the Soviets did or were

capable of exploiting what they might have acquired. The study also assumed that disapproval implied denial, an assumption that is unrealistic for many technologies and, for any particular technology or product, less and less realistic as time goes by.

The study's estimates that the Soviet Union could have saved $6.6 to $13.3 billion over a 13-year period by acquiring the items specified in the sample of license applications, and that additional allied expenditures of $7.3 to $14.6 billion would be required over the same period to compensate for such gains, are the judgments of a group of military experts whose criteria and assumptions are only partially stated. The more widely quoted assertion that "the cumulative costs of the Soviet long-term acquisition program are much higher--perhaps $20-50 billion per year"[5] is not supported in the text of the report. In view of these uncertainties and lacking access to information that might resolve them,* the panel must question how much weight these estimates should be accorded.

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* The panel requested but did not receive back-up data for both sets of estimates.

THE EFFICIENCY OF EXPORT CONTROL ADMINISTRATION

The Export Administration Regulations have evolved over a long period and currently fill more than 570 pages of the Code of Federal Regulations. Understanding and applying the rules are difficult tasks even for full-time, experienced, technically trained, English-speaking export licensing specialists. The system's complexity alone imposes considerable costs on and often undermines compliance by exporting firms. The burden is heaviest on small- and medium-sized companies that are unable to spread the costs over a large volume of export business.

For the exporter, obtaining, using, and (in the case of distribution licenses) keeping export licenses entail an elaborate series of procedures, some of them requiring sophisticated technical judgments. The scope and mechanics of a compliance program will vary with the commodities being exported, the size of the company, and the type of validated license employed. Nevertheless, certain activities are required of all companies that export controlled goods.

- The exporter must properly classify each export product within a category on the U.S. Control List, normally with assistance from in-house technical experts and sometimes from outside consultants.

- If prior government approval is needed for exports of its products, the exporter must prepare and submit license applications, each of which may require at least several hours of effort. Individuals must be trained in how to prepare applications and must be prepared to monitor their progress to ensure that the applications are not lost or delayed by the U.S. government. Assistance from outside consultants is sometimes required.

- The exporter must keep careful records of each individual shipment under an export license; submit to U.S. Customs a shipper's export declaration, listing the license authority for each shipment; and ensure that all shipping documents contain the required destination control statements.

- The exporter must monitor additions to the Table of Denial Orders (the list of parties denied the privilege of purchasing U.S.-origin goods or technology) as well as changes in the Export Administration Regulations. Commerce Department notices of amendments to the regulations--ranging from major changes in the rules governing particular types of licenses to revisions of control list entries to minor technical corrections--appear in the Federal Register on an average of slightly less than once a week.

- The exporter must review all of its "exports" of technical data, including international telephone conversations, servicing and installation activities abroad, and employment of foreign nationals, to ensure that any necessary license authority has been obtained. In many cases, the exporter must obtain prior U.S. government approval for a technology transfer or obtain a written assurance of compliance with U.S. law from the recipient of the technical data.

- The exporter must maintain tight controls over servicing activities, including exports of spare and replacement parts, to ensure that proper license authority has been obtained.

- The exporter may need to advise or assist its foreign affiliates and customers in obtaining license authority for reexports of U.S.-origin products from one foreign country to another or for exports from a foreign country of a foreign-made end product containing U.S.-origin parts and components.

Distribution license holders and their approved foreign consignees are required, in addition, to implement a series of internal control measures that are unique to that type of license. These measures include designating and training employees with export control responsibilities; screening customers against the denial list, nuclear end-use restrictions, and a profile of potential diverters; screening transactions against product and country restrictions on the use of the license; and maintaining extensive records to enable the Commerce Department to conduct periodic audits. In addition, distribution license holders are required to inform, train, and audit their approved foreign consignees and to correct and report instances of noncompliance.

In addition to incurring administrative costs, exporters have difficulty interpreting the regulations and obtaining authoritative advice and clarification. For example, proper classification of a product is obviously crucial to compliance; but even engineers often find the U.S. Control List performance specifications, exceptions, and qualifications highly confusing because the terms and measurements often differ from those conventionally used in industry. The Commerce Department will issue a

classification decision in response to a written request. Such determinations have been given low priority, however, and commonly have taken several weeks or even months to process. Personnel assigned by the Commerce Department to respond to telephone inquiries are typically of little help on technical matters. Abroad, U.S. embassy officials are frequently ill-informed about even general EAR requirements. Neither, in any case, can render advice that binds the government.

In circumstances of confusion, uncertainty, or ignorance, many exporters err on the side of caution, submitting unnecessary applications for validated licenses. Seventeen percent of all processed applications in the sample of licenses taken six months after the introduction of the GCOM license were found to be eligible for this general license for low-level technology to CoCom-member countries--and therefore need not have been filed and reviewed at all. Instead of returning such filings with a notation that they are eligible for a general license, the Commerce Department finds it easier simply to process license applications that are submitted in error. Even so, exporters who take elaborate precautions frequently find that their submissions are not in strict compliance with the regulations.

There is a pressing need to rewrite, simplify, and condense the Export Administration Regulations and to upgrade the competence of Exporter Services and diplomatic personnel to provide timely, accurate assistance.

Processing Times

A perennial concern of Congress, the business community, and the responsible agencies has been the time it takes to process licenses, especially IVLs. Some improvements have been made in response to statutory deadlines and other congressional pressures and as a result of partial automation and decontrol actions. Nevertheless, licensing delays and uncertainties remain a problem for a significant percentage of export transactions.

Shipping delays impose immediate financial costs on the exporter as well as a longer-term cost in customer confidence. When a product is available but cannot be shipped on receipt of an order, warehousing and other carrying costs are incurred. More expensive means of transportation may need to be used to make up for the delay in obtaining a license, and the exporter may have to pay

contract penalties to the purchaser and to subcontractors who supply components and assemblies. In some cases, sales are lost altogether.

The objective of efforts to improve licensing efficiency has been to reduce average processing times. In contrast to the four-week average reported by the Commerce Department, respondents to the survey commissioned by the panel reported a six-week average processing time. This discrepancy is explained in part by a difference in definition. For the department, the clock starts when the application is recorded and stops with final issuance of the license or other action. For the exporter, the time extends from the mailing of an application to the receipt of a license or adverse decision, not counting the time spent in license preparation, obtaining end-use statements, and other steps preparatory to submission. As far as the exporter's ability to ship is concerned, the latter or total processing time is, of course, determinative.

In contrast, license application turnaround times by the governments of other CoCom countries are generally much shorter. In Japan, for example, the Ministry of

International Trade and Industry (MITI) usually responds within two or three days to applications for exports to Free World destinations. But the important difference is not the number of days. Rather, it is the pattern, in Japan and elsewhere, of consultation between companies and government officials, prior to the submission of applications and coincident with negotiations between exporters and their customers. The licensing agency signals its likely approval or disapproval early on in these discussions, removing or at least minimizing uncertainties as to timing and outcome--uncertainties that U.S. exporters frequently experience and that complicate their business dealings.

U.S. averages obscure, moreover, the highly skewed distribution of processing times. In the first quarter of 1986, the average processing time (according to the Commerce Department's definition) was 25 days, with roughly three-quarters of the cases completed in less than that time. But the distribution has an extended "tail," stretching as long as several months and, in a few instances, even years.* It is the cases in this tail that absorb a

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* One U.S. company prepared for the panel a detailed chronology of a license application that was ultimately approved after 910 days, extending from March 1983 to November 1985. The application was for the sale for a $450,000 NMR spectrometer to a medical research institute

large proportion of the corporate resources devoted to working the system and that create uncertainty in the market. The number of such cases is not insignificant; for approximately 5 percent of cases, the processing time extends beyond 100 days. Several U.S. companies report that their customers are now insisting that sales contracts contain contingency clauses permitting abrogation of agreements that do not receive approval within a reasonable period of time.

The panel concludes that more effort should be devoted to minimizing or eliminating the uncertainties of the licensing process. Reducing further the average time a license application is under Commerce Department or interagency review is a worthy objective; but it would not necessarily have a significant effect on total processing times, the

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in Eastern Europe. Although U.S. firms pioneered the development of NMR technology, German and Japanese companies now hold two-thirds of the world market. In fact, during the review period, a German competitor sold several similar systems to bloc customers. NMR instruments do not appear on the U.S. Control List, but the equipment in question was subject to validated licensing requirements because it incorporated 32-bit microprocessors and 30-megabyte Winchester disk drives, components produced in the millions in several countries. Throughout the lengthy process of review, the applicant intervened repeatedly to keep the license under active consideration. But at no point was the company advised of any rationale for the concern that the product might be diverted and could contribute significantly to Soviet military efforts.

predictability of the process, or the skewed distribution of processing times.

For many types of transactions, primarily those involving sales of most types of products to allied countries, the licensing system does operate with reasonable predictability--that is, an exporter can count on obtaining approvals within a fairly consistent period of time. For other transactions, both West-West and East-West, the probabilities of a delayed response, of having an application returned without action, of receiving approval with conditions on the configuration of the product, and of apparent inconsistencies in the treatment of similar applications are much higher. In these circumstances, the burden is on the exporter to take steps to prevent the process from becoming bogged down and to avert outcomes that effectively negate the sale or alienate foreign customers. A common frustration among exporters in this regard is the difficulty they experience in obtaining sufficient information on the status, whereabouts, and prospects of license applications to coordinate production and shipment and to keep customers informed.

Firm-Size Differences

The complexity, inefficiencies, and uncertainties of the licensing process suggest that the system creates its own scale economies and barriers to entry. Export controls are not designed to discriminate against small firms, but their operation adds to other difficulties small companies commonly experience in marketing internationally--difficulties in identifying markets, obtaining financing, and negotiating other hurdles to foreign trade.

There is no estimate of the amount of exports foregone because the perceived costs of export controls discourage firms from doing international business in controlled products. Nevertheless, the panel's survey data indicate that, with regard to processing delays, inaction, conditional approvals--and other factors contributing to uncertainty--there are pronounced firm-size differences in the administration of national security controls.

Small-firm applications to Free World destinations take 25 percent longer, on average, than those of large-volume exporters. The processing time variance (longest processing times relative to average time) is 21 percent for large

firms, 70 percent for medium-sized firms, and 150 percent for small firms. The likelihood of receiving a denial is two-and-one-half times greater for small exporters than for large ones; the probability of having an application returned without action is nearly three times greater; and the chances of having to modify the product or attach conditions to its use are also nearly three times greater. The fact that large companies make much more extensive use of bulk export authorizations, such as distribution licenses, that obviate the need for prior approval of individual shipments simply compounds the differential. Complex regulatory schemes often have the unintended effect of discriminating against small enterprises. Export control administrators should take whatever steps they can to minimize these disadvantages.

COMPETITIVE EFFECTS OF CONTROLS

The panel's survey respondents,* reflecting on their experience over the 12 months prior to May 1986, perceived

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* The sample of companies surveyed was oriented toward firms in the electronics (equipment and components), aircraft (airframes, engines, and parts), instrumentation, and machine tool sectors. The 170 respondents accounted for roughly $36 billion of foreign sales in 1985, or approximately 28 percent of estimated total U.S. high-technology sales.

the control system as frequently having significant adverse effects on their business:

- o 52 percent reported lost sales primarily as a consequence of export controls;
- o 26 percent had business deals turned down by Free World customers (in over 212 separate instances) because of controls;
- o 38 percent had existing customers actually express a preference to shift to non-U.S. sources of supply to avoid entanglement in U.S. controls; and
- o more than half expected the number of such occurrences to increase over the next two years.

Before considering whether there is evidence of the magnitude of these effects, we need to review briefly the scope of coverage of the control system, a few of the analytical and practical difficulties of determining the magnitude of the trade impact, and the possible sources of adverse effects on U.S. competitiveness.

Scope of Coverage

Determining the value, size, and composition of the share of U.S. export trade affected by national security export controls is itself an elaborate and uncertain exercise. Nevertheless, a reasonable estimate is that in 1985 the United States exported $62 billion of dual use manufactured goods under the two most frequently used types of validated licenses--IVLs and distribution licenses.* Excluding military equipment, controlled exports therefore constituted about 40 percent of total U.S. exports of manufactures in 1985 (more than one-half of manufactured exports to all

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* This estimate was derived from Commerce Department and survey data, as follows:
(1) Exports under Individual Validated Licenses. In FY1985, the Commerce Department issued licenses for approximately $50 billion of manufactured goods. Included in this figure was approximately $6.4 billion in reexport authorizations. The Commerce Department and survey respondents agree that about 85 percent of the value of approved individual licenses is actually shipped. Further, although the $50 billion of approved licenses does not include military equipment licensed under the ITAR regulations, it does include a small percentage--probably as little as 1 percent--of items controlled for foreign policy reasons. Thus, the value of national security controlled, dual use manufactures exported directly from the United States under IVLs in FY1985 was approximately $36 billion.

destinations except Canada, for which no validated licenses are required) and were almost equivalent to the value of all high-technology exports (including exports to Canada, which are 12 percent of the total), as defined by the Department of Commerce (see Figure 5-1). Very likely, these shares have increased in recent years, but the data, unfortunately, do not permit historical comparisons.

As expected, the types of commodities that bear the brunt of controls--computers, aircraft and parts, instruments, electronic components, and communications equipment--are also the leading U.S. high-technology exports. But there are some curious anomalies. In the largest Control List category,

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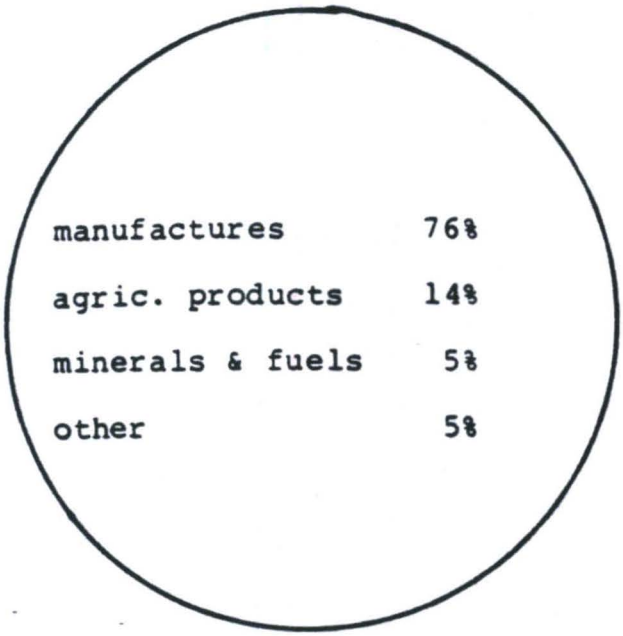
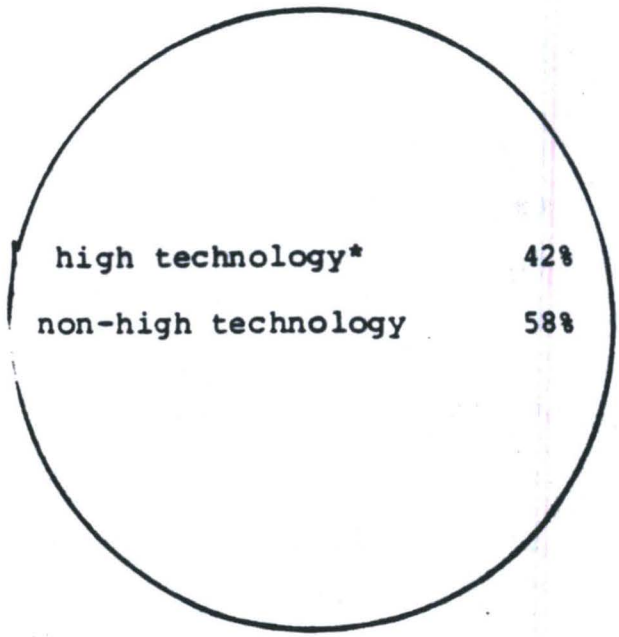
(2) Exports under Distribution Licenses. In response to a questionnaire mailed to export administration personnel of all holders of distribution licenses, 107 companies or corporate divisions reported that in calendar year 1985 they exported nearly $3.7 billion worth of manufactured goods under 109 licenses. If anything, large companies (over $250 million annual sales) were underrepresented in the sample, which represented 17 percent of the estimated 650 distribution licenses outstanding in 1985. Thus, a conservative estimate of total direct U.S. exports under distribution licenses in 1985 is $22 billion. This figure is significantly higher than a recent Commerce Department estimate (of $12 to $15 billion) that was derived from a sample of 1985 shipper's export declarations (SEDs), documents submitted to the Bureau of the Census. The latter sample excluded SEDs filed electronically, typically by large exporters. It should be noted that the distribution license is not available for the most sensitive dual use products, for munitions, or for items restricted to particular countries for foreign policy reasons.



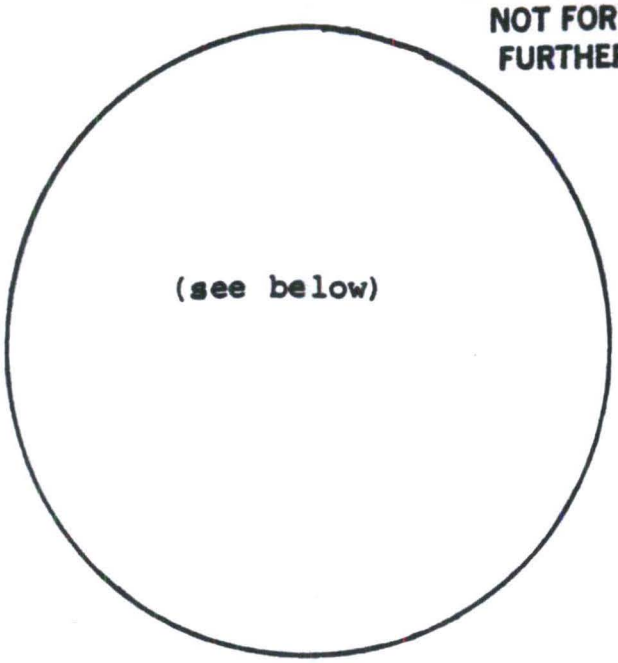
Composition of U.S.
Merchandise Exports, 1985



Composition of U.S. Exports
of Manufactures, 1985

*DoC3 definition

Figure 5-1: Export Coverage of U.S.
National Security Export Controls



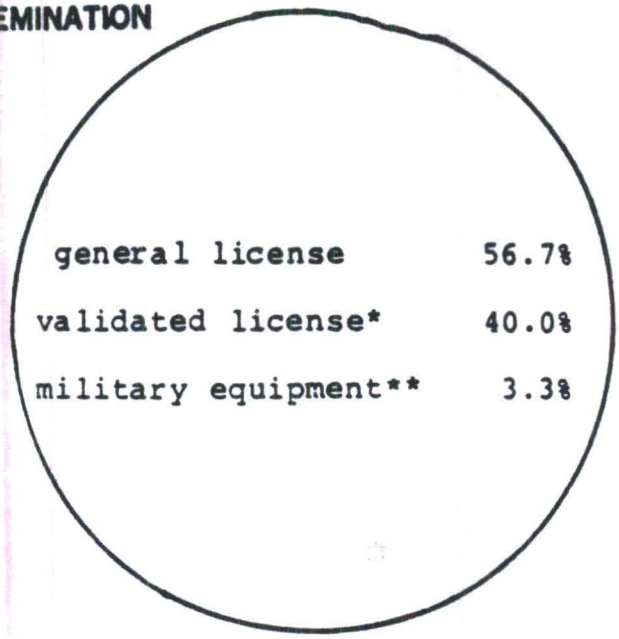
Composition of U.S. Exports of High Technology Goods, 1985

dark shading (heavily affected by NSECs on dual-use goods):
- communidations equip./ electronic comp. 19.7%
- aircraft/parts 25.6%
- office comp./acctng equip. 22.5%
- prof./scient. instrum. 10.4%
- engines/turbines/parts 4.6%

light shading (somewhat affected by NSECs on dual-use goods):
- indust. inorganic chem. 4.9%
- plastics/resins 6.0%

white (not affected by NSECs on dual-use goods):
- drugs and medicines 4.0%

cross-hatch (heavily affected by munitions controls):
- missiles/spacecraft 1.2%
- ordnance/accessories 1.0%



License Authority for U.S. Exports of Manufactures, 1985

*exports under IVLs and DLs
**mainly licensed individually under ITAR

Figure 5-1 (cont.)

Sources: U.S. Department of Commerce; consultant reports

electronic computing equipment (ECCN 1565), the Commerce Department approved roughly $23.5 billion in exports under IVLs alone; but the United States exported only $15 billion worth of computers in calendar year 1985. This discrepancy is attributable to several factors;[6] but, most importantly, it indicates that the control list classification is at variance with the classification of trade data and even with common understandings. ECCN 1565, in particular, encompasses a wide range of products that are licensed as computers because they contain a microprocessor but that are shipped under other product designations specified by the government for statistical purposes.

From a corporate perspective, the control system's coverage is also very broad. Survey data, in combination with Commerce Department information, indicate that between 2,000 and 3,000 organizations apply for licenses each year.

But even these numbers greatly understate the amount of business activity reached by U.S. controls. The national

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(3) Exports under other bulk licenses. Survey respondents reported that their shipments under service supply and project licenses are no more than __ percent of their total exports. The value of all manufactured goods shipped under these bulk licenses in 1985 was about $4 billion

security export control regime covers not only products and technology as they flow across U.S. borders but also a range of transactions by U.S. subsidiaries and foreign firms abroad. The latter include, for example, sales of products produced, manufactured, and distributed offshore by U.S. affiliates and sales of products manufactured by foreign companies incorporating U.S. components or produced with U.S. technology. The $6.4 billion worth of reexport approvals that were issued in 1985 are only the tip of the iceberg because many reexports are authorized at the time original IVLs are obtained, and because the reexport authority of the distribution license is used much more extensively than are individual reexport authorizations. The value of data transfers under general license GTDR cannot be determined. Initially, the adverse competitive effects of the control system may show up only outside the United States, although eventually they will affect U.S. export trade.

Lack of Economic Analysis

The complexity of international business operations is only one of the reasons that there has been no credible estimate of the economic cost of national security controls.

To date, the Department of Commerce, despite its trade promotion mandate, has undertaken no economic analysis of national security export controls. Affected exporters presumably are in the best position to know the extent of the administrative burden and lost sales resulting from controls, but they have great difficulty even estimating these costs. Sales personnel are not usually engaged exclusively in administering controls, and statistics on lost sales are not kept. Furthermore, customers rarely articulate the reasons for choosing one supplier over another, let alone assign relative weights to all of their considerations--price, specifications, quality, delivery time, and so forth. In the unusual circumstance in which controls are known with certainty to have been the sole or principal obstacle to a sale, disclosure of the circumstances poses some risk of harm to the company's future sales by raising questions about its reliability as a supplier. Finally, because of industry reluctance, for commercial and legal reasons, to disclose proprietary information to other firms, there is no mechanism to aggregate and analyze individual exporters' experience. For a variety of practical reasons, therefore, the business community's assertions regarding the costs of export controls are supported only by anecdotal evidence.

Like efforts to quantify the benefits side of the equation, analysis of costs is hampered by certain inherent analytical problems. First, the continuity of national security export controls precludes examination in most instances of before-and-after effects on trade performance. In contrast, analysts have been able to estimate, with some degree of confidence, the economic effects of foreign policy trade sanctions that have a clearly delineated beginning and sometimes an end.[7] Second, the effects of export controls overlay and, hence, are difficult to isolate from a variety of other competitive factors such as exchange rates, general economic conditions, and specific sectoral conditions. Third, the licensing system cuts across a broad range of industries. Not only do the effects vary by sector, but they also vary over time and in how they are manifested--loss of sales, erosion of distribution network, delay in shipments, and so forth. To capture all of such diffuse effects and distill them into a single number is a practical impossibility. Nevertheless, knowing the sources of the competitive costs and the broad range of products affected permits analysis of discrete aspects of the economic cost issue.

[N.B. Additional language (approximately 2-3 paragraphs) is to be inserted at this point presenting the results of an analysis commissioned by the panel on the direct economic costs of U.S. national security export controls. This report, which does not bear reference to any classified material, was received only shortly before the panel concluded its work, and it is therefore still under evaluation. Nevertheless, the report itself is included here as Appendix 4. The supplementary language ultimately approved by the panel will be included in the final draft of the report.]

Sources of Competitive Costs

The control system poses major barriers to U.S. high-technology trade directly with the Soviet Union and Eastern Europe. For some U.S. industries (e.g., machine tools) and for some individual companies, Soviet bloc countries theoretically could represent significant markets, as they do for certain Western European sectors and firms despite the roughly uniform ground rules among CoCom member countries with respect to East-West trade. Nevertheless, as the leader of the Western Alliance, the United States has been and for the foreseeable future is likely to be somewhat

more restrictive than its allies. Moreover, structural features of the nonmarket economies, primarily their enforced self-sufficiency and limited ability to produce competitive goods for world markets, severely restrict their foreign exchange earnings and, hence, their imports. For what manufactured goods the Soviet bloc does import, the proximity of Western Europe and Japan and their greater use of Soviet energy and raw material exports makes them more likely suppliers than the United States. In the unlikely event that the United States could capture the same share of Soviet bloc imports that it holds in total world manufactures trade (approximately 20 percent), U.S. exports would increase on the order of $3 billion to $4 billion. A realistic estimate of U.S.-Soviet bloc trade loss attributable to export controls would not be insignificant, but it would be smaller than the range noted above.

Of much greater concern are the potential costs of export controls on U.S.-headquartered industrial firms engaged in West-West trade. These costs are a function of the significant differences in national treatment of internationally competitive suppliers of technology.

Among the disadvantages to U.S. exporters vis-à-vis CoCom country competitors are the following:

- In contrast to the time delays and high level of uncertainty characterizing U.S. individual (IVL) licensing, which conceivably discourage some producers from exporting altogether or from exporting certain products, other CoCom country licensing systems are characterized by rapid processing, prior consultation between exporters and licensing officials, and a high degree of predictability.

- For national security reasons, the United States unilaterally controls some 27 categories of products and technologies that are not included on the Cocom International List.[8] Among other CoCom members, only Canada and Germany maintain unilateral national security export controls, but these are limited to certain kinds of chemical products and nuclear items, respectively.

- The United States often requires foreign resellers to obtain a U.S. reexport authorization for U.S.-origin end products, U.S.-origin parts and components incorporated

in foreign equipment, and even foreign products manufactured with U.S.-origin technology. No other CoCom member imposes reexport controls, and many do not use the other devices employed by the United States (e.g., denial lists and end-user and postshipment checks) to prevent the diversion of controlled goods from non-CoCom Western countries. (See Chapter 6 and Table 6-1.)

- In the past, U.S. bulk licenses, especially distribution licenses, have been <u>less</u> restrictive than some foreign licensing systems that rely even more heavily than does the United States on prior review and approval of individual transactions. Nevertheless, the U.S. distribution license procedure has recently become relatively more restrictive as these license holders and their foreign consignees have been required to establish internal control systems subject to U.S. government audit and as other CoCom members (Japan, France, and the United Kingdom) have adopted bulk export authorizations with less stringent conditions.

Among the disadvantages to U.S. exporters vis-à-vis non-CoCom country competitors are the following:

- In contrast to the elaborate system of U.S. controls, few non-CoCom countries (exceptions are Switzerland, Sweden, Austria, India, and Yugoslavia) maintain any national security controls on dual use exports.

- U.S. bilateral efforts to conclude control agreements with third countries disadvantage U.S. firms in relation to their competitors: in the short run, by the use of license denials or delays as an instrument of negotiating leverage; and, in the long run, in cases in which a country agrees to control only exports of U.S.-origin technology.

The Panel's Analysis

As the relative restrictiveness of U.S. controls becomes more apparent abroad, foreign customers are exploring alternative sources, and some already have turned to non-U.S. suppliers. At the same time, U.S. firms are losing their relative competitive edge, not only in technological

sophistication but also in price competitiveness, product quality, marketing, and service--factors that previously compensated for the negative competitive effect of export controls.

U.S. producers of medium- and lower-level technology products are most vulnerable because increasing numbers of non-U.S. sources, many of them with cost or other competitive advantages, exist for these items or for their essential components. Not only does the U.S. national security export control system weigh more heavily than the controls of other countries with increasingly competitive suppliers, but it also captures a great many lower-level items and treats them on a par with more advanced technology having greater military significance. Although the benefits of controls appear to be concentrated in a few technology areas, the costs are spread across a wide range of products of varying sophistication and strategic importance.

The panel developed two analyses that support the extensive anecdotal evidence acquired on its foreign visits and presented in briefings by exporters. The first analysis deals directly with the question of lost sales, in this case

those resulting from the imposition of unilateral controls. The second indicates that extraterritorial controls are having on adverse effect on the structure of business operations by which U.S. firms establish and maintain a competitive position in world markets.

(a) The Case of Analytic Instruments

The category of analytic instruments provides a unique opportunity to isolate and measure the effects of U.S. unilateral export controls because of discrete regulatory changes in 1984 that affected products containing embedded microprocessors. In April 1984, following an extended public and internal government debate, the Department of Commerce announced decontrol of roughly one-half of the categories of instruments previously requiring a validated license. Eight months later, however, the department issued interpretations of new CoCom agreements redefining incorporated microprocessors and reimposing controls on the same instrumentation categories. The U.S. interpretations were more restrictive than those of other CoCom countries, and, thus, the renewed controls again were essentially unilateral.

After adjusting for changes in exchange rates, price levels, and level of foreign industrial production, an analysis commissioned by the panel indicates that, when controls were relaxed early in 1984, U.S. analytic instrument exports increased (by the third quarter of 1984) roughly 7 percent over what they would have been without the change. Using the same assumptions and adjustments, the analysis shows that when the relaxation was reversed late in 1984, exports (by the third quarter of 1985) were 12 percent below what they would have been if licensing requirements had not been reimposed. These fluctuations in trade reflect only the short-run observable effects probably attributable to unilateral export control. In the long term, the on-off on-again controls may erode the desire of foreign customers to purchase U.S. products. Also not reflected in the analysis are the effects these restrictions may have had on foreign transactions in similar instrumentation produced abroad with U.S. technology or containing U.S. components.

(b) The Case of Foreign Consignees Under Distribution Licenses

In May 1985, the Commerce Department issued new regulations requiring distribution license holders and their

foreign consignees to protect controlled items from diversion to the Soviet bloc by establishing internal control and recordkeeping systems subject to on-site inspection by agents of the license holder and the U.S. government.[9] For the vast majority of U.S. exporters and their affiliates holding distribution licenses, the flexibility of the license unquestionably outweighs the administrative and other perceived costs of the new restrictions. But the combination of increased administrative costs, foreign sensitivities to the extraterritorial application of U.S. law, and, in the case of firms located in other CoCom countries, the duplication of effort entailed in complying with domestic as well as U.S. export control regulations raises a concern that the rules discourage independent foreign companies from doing business with U.S. suppliers.

Surveyed in May 1986, only one month after the regulations became fully effective, distribution license holders responding (accounting for approximately 18 percent of the total number of licenses) reported the loss or removal of 32 percent of all their foreign consignees--1,175 out of 3,686--in the previous twelve months since the regulations were issued. Business changes unrelated to the regulations,

inactivity, and product decontrol actions were reported to account for one-half of these drop-outs; but the expense of compliance and consignees' refusal to comply accounted for 40 percent of the cases. More often than not, business is continuing with former foreign consignees under different licensing arrangements. Nevertheless, 28 licensees (25 percent of the sample) reported an immediate loss, albeit in the near term a small loss, of business as a result of the drop-outs. Companies also reported that, under the new requirements, it is becoming more difficult to recruit new consignees and that some consignees have reduced their orders although they remain on a distribution license.

Again, these findings represent only the short-run, observable effects of the regulations. Other evidence indicates that a number of foreign companies that chose not to terminate relationships with U.S. suppliers abruptly are now exploring alternative sources for the future.[10] A crucial stage in implementing the regulations is approaching as license holders and the Department of Commerce begin systematic auditing of foreign consignees. In the meantime, the regulations have already brought about some erosion of the distribution networks of U.S. exporters, a marginal loss

of business, and an increase in the volume of individual license applications.

TECHNICAL DATA CONTROLS

Some firms find it difficult to understand and apply the general license GTDR and validated license requirements for the export of technical data. There is substantial confusion regarding what transactions (i.e., oral communication with foreign nationals, visual inspection by foreign nationals within the United States, and application of knowledge abroad) are considered to be "exports"; and there also is uncertainty as to what transfers are unrestricted (and thus eligible for general license GTDA) or require written assurances of nondisclosure by the recipients (under general license GTDR). Some firms argue that the requirements associated with GTDR inhibit internal corporate information flows without affording any more protection than customary corporate procedures for handling proprietary information.

Of greater concern to the panel, however, is the prospect of greatly expanded controls on technical data including data

arising from research. There are at least four manifestations of this emerging policy thrust.

First, the Department of Defense is moving to place restrictions on unclassified technical data developed in DoD-sponsored research and falling within a category on the Militarily Critical Technologies List. Although the export of such data always has been subject to the provisions of EAR and ITAR, domestic U.S. dissemination was unfettered. The current initiative relies on authority in the 1984 DoD Authorization Act to exempt such data from public disclosure through requests under the Freedom of Information Act.[11]

The panel does not question the authority of DoD to control unclassified technical data from militarily sensitive research projects it funds. Nevertheless, extending controls to data that relate to the wide range of technologies on the

MCTL* and allowing access only by previously certified U.S. and foreign researchers in industry and government would seriously encroach upon the exchange of information in the technical community without necessarily enhancing national security.

Of particular concern is the impact of this new system on the communication of research through professional society meetings and publications. Communication fostered by scientific and engineering society activities has been crucial to the rapid advancement of commercial and military technology in the United States and, thus, to national security. Although Soviet access to this communication is of legitimate concern, the panel believes the risks are

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* Under a policy directive of October 29, 1986, the National Security Council has instructed all federal departments and agencies to safeguard sensitive but unclassified information in government telecommunications and automated information systems. Although it is left to agency heads to identify "sensitive" information, whose disclosure, loss, or destruction could damage national security or other government interests, the directive refers specifically to technological as well as other kinds of information. The directive does not, however, specify the means for protecting such information (for example, whether it is to be withheld from data bases such as the National Technical Information Service or, alternatively, whether access to such data bases is to be restricted); nor does it refer to penalties for unauthorized disclosure.

outweighed by the important role of open and rapid communication of ideas and findings, including conceptual dead-ends, in promoting innovation.

A second manifestation of efforts to expand controls on technical data concerns patent information. Serious constraints on the use of new knowledge to benefit U.S. commercial and military activities could result from the development by the Patent and Trademark Office, in consultation with the Department of Defense, of a new type of patent secrecy order.[12] The order can be issued when a patent application contains unclassified technical data relating to inventions with military or space application. Although the patent would be withheld until the secrecy order was lifted, the data contained in the application could be disclosed to U.S. residents; the invention could be developed and marketed domestically; and the inventor could apply for patent protection in most European countries and Australia. Other foreign disclosure or marketing could occur only under a validated export license. Because the applicant would not be authorized to file for patent protection in most newly industrializing countries, marketing this invention could lead to legal pirating by enterprises in those countries.

Use of the MCTL or any other broad criteria as guidance could result in subjecting a considerable number of applications to such secrecy orders. The panel believes that extensive use of secrecy orders would undermine the benefits of the patent system, increase the duplication of R&D activities, and result in important innovations being withheld from commercial markets.

Third, the Department of Defense is in the process of culling from the MCTL a subset of critical dual use technologies with an eye to proposing that they be subject to validated licensing to Western destinations.[13] Of all the initiatives to restrict transfers of technical data, this is the most troublesome because controls would not be limited to know-how or inventions derived from government-sponsored research and development or contained in patent applications but would apply regardless of the information's origin, form, and means of transfer--personal, print, or electronic.

Despite the problems associated with it, general license GTDR remains critical to the ability of many U.S. firms to conclude sales, explore international joint ventures, and transfer research results to foreign business partners.

Requiring a validated license for data covered by broad categories of the MCTL would significantly alter the nature of communications within the Free World. Although the comprehensive operations license authorized in 1985 might limit the burden on large multinational firms, other companies with less well-established international operations would be adversely affected.

There is little doubt that unclassified but militarily sensitive technical information can be diverted from Western channels of communication; but there are enormous practical difficulties as well as political and economic risks in treating technology in the same manner as tangible products. The flow of technical data within and among enterprises is essential to their operation. CoCom agreement to adopt similar restrictions is doubtful; some member governments lack legal authority to control intangible data. Finally, it is not clear that the benefits the Soviets derive from adapting, applying, diffusing and improving upon unclassified technical data acquired from the West are substantial enough, relative to other means of obtaining technology, to warrant broad application of intrusive controls.

USE OF THE MILITARILY CRITICAL TECHNOLOGIES LIST

Regardless of the regulatory mechanism, the panel is concerned by the prospective use of the Militarily Critical Technologies List as a de facto, and possibly unilateral, control list for technical data. It also considers unwise and unworkable the long-standing congressional mandate, renewed in the 1985 Export Administration Amendments Act, to integrate the MCTL with the U.S. Control List, except on a case-by-case basis in which CoCom negotiation and agreement precede the adoption of a new control by the United States.

As mandated in the Export Administration Act of 1979 and revised periodically by the Department of Defense, the complete MCTL is a classified document of 800 pages, including specifications and justifications. An abbreviated, unclassified version was published in October 1984. Updating has not changed its initial character. The MCTL is an extensive compilation of militarily useful technologies and equipment. It lacks prioritization and reflects the paucity of detailed information on near-term and long-term Soviet needs and capabilities. Further, the MCTL's development has not been disciplined by considerations of clarity, foreign

availability, or enforceability, considerations that should be reflected if it is to be used as an operational control list accessible to licensing officers and exporters. The MCTL serves a useful but limited purpose as a reference document for developing control proposals and making informed licensing decisions. Explicit internal DoD guidance could enhance the latter role and dispel much of the confusion that surrounds the MCTL.

The Militarily Critical Technologies List was an attempt to embody general control criteria developed by a 1976 task force of the Defense Science Board, under the chairmanship of J. Fred Bucy.[14] The Bucy task force implicitly faulted the traditional emphasis on controlling exports of products for neglecting the source of any nation's industrial capability and of the U.S. military advantage over the Soviet Union in particular--mastery of the know-how required to specify, design, build, test, maintain, and use sophisticated products. The Bucy task force instead proposed controls on critical design and manufacturing processes; essential manufacturing, inspection, and test equipment; and operation, application, and maintenance data accompanying products. Furthermore, the task force urged closer scrutiny of

revolutionary rather than slowly evolving technologies and of active means of transfer--for example, turnkey factories, training, and ongoing technical exchanges--rather than routine sales of products.

The Bucy criteria have strong theoretical appeal but have proven to be extremely difficult to put into operation. They rely on distinctions--"critical," "revolutionary," "keystone"--on which opinions are widely variable and difficult to reconcile. As the panel's observations on technical data controls indicate, it is especially hard to define categories of know-how that need to and can be controlled, beyond proprietary protections but short of security classification, without disrupting routine and vital technical communication.

THE POLICY PROCESS AND THE BALANCING OF U.S. INTERESTS

The panel's findings underscore the need for a policymaking process that will continue to generate new information and weigh conflicting judgments. Economic and technological change in the West requires continuous

balancing and rebalancing of diverse national stakes. Divided administrative responsibility, congressional oversight checks on administrative discretion, consultation with private industry, and negotiations with allies can ensure that some balancing of views and interests occurs in the evolution of export control policy. But these long-standing features of the policy process have limitations and drawbacks and are not up to the challenge of reconciling controls with the need to sustain a vigorous technological enterprise in an increasingly competitive international economy.

In many areas of economic and social regulation in the United States, federal statutes, executive orders, or judicial decisions directly require or indirectly encourage analysis of costs and benefits. This is not the case with export controls. Because they involve matters of foreign and military affairs, both national security and foreign policy export controls are exempt from the Administrative Procedure Act (5 USC 553), which provides for judicial review and for notice of and public comment on proposed regulations, and from Executive Order 12291, which mandates economic impact analysis of most domestic regulations.

To impose export controls for foreign policy purposes (or to maintain them after their automatic expiration after one year), however, the Export Administration Amendments Act of 1985 requires the president to determine that the adverse effects on U.S. export performance, the reputation of U.S. companies as reliable suppliers, and the welfare of companies, their employees, and communities will not exceed the foreign policy benefits. Further, before applying foreign policy controls, the president first must have tried other means to influence the offending country's behavior. He also must have consulted with Congress, industry, and other countries so that he is in a position to certify to Congress that the actions he is considering are likely to achieve their objective, are enforceable, and are not likely to be undermined by the behavior of other countries. The General Accounting Office is directed to "second-guess" the president's judgments and to determine whether they meet the statutory criteria. None of these formal checks and balances, intended by Congress to contain the costs and ensure the effectiveness of the president's actions, applies to national security export controls. Nor has the bureaucratic structure served to produce analysis and debate.

Shared responsibility among agencies with diverse and often conflicting perspectives has been a chronic feature of export control policy and administration. The Export Administration Act assigns the Department of Commerce primary responsibility for the list of controlled dual use goods and technologies and for administering and enforcing the licensing system. The Department of State has the lead in negotiations with other countries, both CoCom and non-CoCom, to achieve cooperation on multilateral controls. The Department of Defense is charged with providing technical advice on the military significance of goods and technologies and the security risks of their transfer to proscribed countries. Finally, the Customs Service has primary responsibility for the enforcement of controls at points of exit and for investigations of diversions abroad.

Although this dispersion of authority has serious disadvantages, the panel believes that both the policy guidance and the division of labor set forth in the Export Administration Act are appropriate. It is not difficult to conceive of alternative arrangements but none promises an ideal balance of the national interests in export controls.

The deficiencies of the current arrangement, however, are threefold. First, there has been no regular policy guidance at the highest level nor an effective means of reconciling differences among the agencies. Second, certain departments, notably Commerce and State, lack resources and assertiveness commensurate with their responsibilities. And third, recent changes within the departments have shifted export control responsibilities away from officials responsible for technology and trade development, resulting in a concentration of authority in administrative units with a narrower perspective.

The lack of an effective overarching mechanism has allowed a legitimate but limited view of military security to dominate without giving sufficient weight to the health of the economy as a crucial element of national security. The White House has intervened only intermittently and then to contain bureaucratic conflict rather than to give policy direction. The Senior Interagency Group on Technology Transfer has been a weak instrument of coordination and conflict resolution. It has not considered its responsibility to be that of balancing the requirements for enhancing U.S. competitiveness, maintaining the U.S. lead in

military technology, and promoting cooperation with our major allies.

DoD's assertiveness on export control issues is not counterbalanced by the Departments of State and Commerce. On its foreign study missions, the panel was told repeatedly that the United States speaks with several voices on technology transfer policy, to the consternation and frustration of foreign negotiators. By the same token, several recent DoD initiatives, notably on the review of foreign availability findings and of license applications to certain Free World countries, have had the effect of weakening the authority of the Commerce Department and the morale of its export administration personnel.

One unfortunate result of the imbalance is the lack of any effective mechanism for weeding out from the control list those products and technologies that have ceased to be strategic or that have become so widely available that control, for all practical purposes, is impossible. The momentum is to add, not to delete, and the principal licensing agency, with a stake in keeping its task from becoming unmanageable, has been unable to slow it down.

A striking example is the failure of the Commerce Department's foreign availability program to yield the results intended by Congress when in 1979 and again in 1985 it mandated a procedure to eliminate one type of ineffective control--on items that the Soviet Union can make or freely buy from uncontrolled sources. According to the statute, foreign availability exists when a non-CoCom-origin item of comparable quality is available to adversaries in quantities sufficient to satisfy their military needs so that U.S. exports of the item would not make a significant contribution to their military capabilities.

A newly created Office of Foreign Availability (OFA), with valuable technical assistance from defense, intelligence, and other agencies, has completed 44 investigations of the availability of items under control or proposed for control. Many of these studies have contributed needed discipline to the process by which new controls are conceived and developed. But most of the 20 assessments of whether or not foreign availability should lead to the removal of existing national security export controls have languished in interagency review for periods as long as eight months. Only two negative findings and three positive

findings, the latter leading to preliminary decisions to decontrol automatic silicon wafer saws and mercury cadmium telluride uncooled array sensors and to modify specifications on floppy disks, have been published. One problem is that, although regulations specify expeditious Commerce Department evaluation of foreign availability claims, no constraints are imposed on the Defense Department's review of OFA findings. The review process is used as a means of delay. Further, DoD narrowly construes the foreign availability criteria to preclude decontrol in most cases. The panel believes that the meager results of this process mean that U.S. industry continues to bear unnecessary costs and the credibility of U.S. controls is further undermined.

Another recent change in the policy process is more subtle but no less consequential. Under the Reagan administration, the bureaucratic balance of power has been shifted toward security, intelligence, and law enforcement agencies and away from those entities responsible for technology development, trade, and international economic relations. In the Defense Department, a new organization, the Defense Technology Security Administration, reporting to the Under Secretary of Defense for Policy, has assumed

responsibility for technology transfer policy--responsibility that previously resided in the Office of the Under Secretary for Research and Engineering. In the State Department, security assistance officials have assumed the lead role formerly assigned to the Bureau of Economic Affairs. The Commerce Department has a statutory mandate to remove export administration from the International Trade Administration to stand on its own just below the Office of the Secretary.

These changes have contributed to a reinvigorated control system, a credible enforcement capability, better threat assessment, a more assertive diplomacy, and even improvements in license processing. The reorganization of Export Administration in the Department of Commerce and the appointment of an ambassador for strategic technology policy in the Office of the Under Secretary of State for Security Assistance, Science, and Technology are two recent positive efforts to upgrade the administrative capabilities of responsible agencies.

But there is a danger in isolating export control functions from trade and technology development responsibilities. The risk is that controls will become

increasingly unrealistic and burdensome on U.S. competitiveness and innovation and that these adverse effects will not be acknowledged until they become obvious and possibly irreversible. The evidence of such effects is limited but sufficient to justify further adjustments in U.S. export control policy and administration.

REFERENCES FOR CHAPTER 5

1. Soviet Acquisition of Militarily Significant Western Technology: An Update (September 1985), Table 1, p. 6.

2. Ibid, p. 6.

3. U.S. General Accounting Office, Export Licensing: Commerce-Defense Review of Applications to Certain Free World Countries (September 1986).

4. Assessing the Effect of Technology Transfer on U.S./Western Security: A Defense Perspective (February 1985).

5. Ibid, p. 5-8.

6. For example, exporters may not use the full amount of license authorizations because sales are not completed or orders are reduced.

7. See, for example, U.S. Department of Commerce, Foreign Policy Report to Congress, January 21, 1985 to January 20, 1986; Stanley D. Nollen, "Business Costs and Business Policy for Export Controls," Working Paper of the National Center for Export-Import Studies, Georgetown University (Washington, D.C., July 1985).

8. Congress has long pressed for the elimination of these unilateral controls, either by decontrol or through CoCom agreement to adopt them as multilateral controls. Although many items have been removed over the years and others, such as communications countermeasures equipment (ECCN 4516B), may be candidates for control under ITAR, a number of unilaterally controlled items appear to have little military significance and probably remain on the control list because of bureaucratic inertia.

9. 15 C.F.R. 373.

10. See "The Technology Gap: Western Countries Growing Apart?" Speech by W. Dekker, president and chairman, N.V. Philips, at the Atlantic Institute for International Affairs, Paris, December 5, 1985; "Reagan Curbs Hit U.S. Electronics

Sales Overseas," Financial Times, October 16, 1986, p. 1; Department of State confidential cable from Bonn Embassy, "Are German firms turning away from the US because of our export controls?" (February 1986).

11. 1984 Department of Defense Authorization Act, 10 U.S.C. 140c. See DoD Directive 5230.25, "Withholding of Unclassified Technical Data from Public Disclosure" (November 6, 1984).

12. Federal Register, Vol. 51, no. 180, pp. 32938-39.

13. U.S. Department of Defense, Militarily Critical Technologies Program (17 July 1986), p. 21.

14. Defense Science Board Task Force on Export of U.S. Technology, An Analysis of Export Control of U.S. Technology--A DoD Perspective (4 February 1976).

HIGHLIGHTS OF THE EXPORT ADMINISTRATION ACT, AS AMENDED, 1985

The EAA, as amended in 1985, tightens some national security controls. However, to the extent we make changes in our regulations, we have authority to permit other controls to be relaxed.

National Security Controls

o Import Sanction - The EAA provides the President with authority to prohibit imports from companies violating U.S. national security controls. He may also bar imports from companies violating COCOM (i.e., foreign) export controls if (1) negotiations with the pertinent government have been conducted; (2) the President gives COCOM partners 60-day notice of intent to impose sanctions; and (3) a majority of COCOM partners concur or abstain.

o Foreign Availability - The EAA requires that an exporter's assertion of foreign availability, if supported by reasonable evidence, be accepted in the absence of reliable evidence. The EAA also requires that the President actively pursue negotiations to eliminate foreign availability, and decontrol items within 6 months if foreign availability has not been eliminated, except that he may extend the period one year by certifying that negotiations are progressing and that decontrol would be detrimental to U.S. national security.

o Intra-COCOM Decontrol - Items at the lowest level of COCOM control, where only notification to other countries is required, must be decontrolled for export to other COCOM countries.

o Controlled Countries - Controlled countries are those set forth in Section 620(f) of the 1961 Foreign Assistance Act, but the President may add (or delete) countries if exports there would make a significant contribution to the military potential of an adversary and prove detrimental to U.S. national security. All Warsaw Pact countries are listed in 620(f), plus Vietnam, North Korea and Cuba (with which we have a complete embargo), as well as China and Yugoslavia.

o Foreign Embassies - The President has the authority to control transfers to embassies and affiliates of controlled countries.

Foreign Policy Controls

In general, the bill significantly restricts the impositions of foreign policy controls by requiring that stricter criteria be met, that a prior report be submitted to Congress, that specified agencies be consulted, that controls be enforceable, and that existing contracts not be interrupted except under certain circumstances;

o Contract Sanctity - Existing contracts or export licenses may not be interrupted unless and until the President certifies to Congress that a "breach of the peace" has occurred which poses a direct threat to U.S. strategic interests, and that curtailment of contracts would be instrumental in remedying this threat. The controls continue only so long as the direct threat persists. (Alternatively, the President may interrupt existing contracts if Congress passes a joint resolution of authorization).

o Criteria - The President may impose or extend controls only if he determines that the following criteria have been met:

-- The controls are likely to achieve their intended purpose (which cannot be achieved in another way);

-- The controls are compatible with U.S. policy toward the recipient nation;

-- Reactions of other nations are not likely to render the controls ineffective;

-- Economic costs to the U.S. do not exceed foreign policy benefits;

-- The U.S. can enforce the controls effectively.

o Consultation and Reporting -- The President may not impose or extend controls until he has submitted a report to Congress which:

-- Specifics the purpose of the controls;

-- Presents his determinations and rationale with regard to the criteria listed above;

-- Presents the results of or plans for consultations with industry and other countries;

-- Lists alternative actions attempted or reasons for imposing export controls without attempting alternative means;

-- Describe foreign source of the goods in question and U.S. efforts to secure foreign cooperation.

o Foreign Availability - After controls are imposed, the President must take "all feasible steps" to eliminate foreign availability. If, after six months, he has been unsuccessful and the Secretary of Commerce determines that goods in "sufficient quantity and comparable quality" are available that would render the control ineffective, the Secretary shall remove the control if he determines that such action is "appropriate." Exempted from this requirement are anti-terrorism controls,

crime control instruments, and controls imposed under international obligations.

o Agency Consultation - Before imposing foreign policy controls, the Secretary of Commerce must consult with the Secretaries of State, Defense, Agriculture, Treasury, and the USTR, as well as other agencies Commerce considers appropriate.

o Reimposition of Controls on South Africa - Prohibiting export of relatively innocuous items to the South African military and policy as well as computers not used in apartheid enforcement to South African Government agencies. (Other anti-South African economic measures were deleted from the EAA, but has been superceded by new legislation.)

Other Provisions

o Agricultural Products - Control effectively made much more difficult.

o Expiration - Act would expire on September 30, 1989.

o Enforcement - Bill continues exclusive Commerce authority to impose civil penalties. Both Customs and Commerce are given authority to investigate export violations.

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S/S # B ●

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FROM:	Bruce Rashkow	L/SFP	647-1074	5420
	(Officer name)	(Office symbol)	(Extension)	(Room number)

MESSAGE DESCRIPTION Letter to the Editor - Wall Street Journal

TO: (Agency)	DELIVER TO:	Extension	Room No.
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FOR: CLEARANCE ☐ INFORMATION ☐ PER REQUEST ☒ COMMENT ☐

REMARKS:

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FORM 3-77 DS-1750

DRAFT

United States Department of State

The Legal Adviser

Washington, D.C. 20520

January 29, 1987

Mr. Robert Bartley
Editorial Page Editor
The Wall Street Journal
200 Liberty Street
New York, New York 10281

Dear Mr. Bartley:

On December 31, 1986 you published an editorial entitled "The Soviets' Lawyers" that commented on the role of the Department of State in two cases in United States courts involving the Soviet Union: the Gregorian case in California involving claims by a private citizen against the Soviet Union, several agencies or instrumentalities of the Soviet Union, and several American corporations; and the Wallenberg case in the District of Columbia involving claims by the half brother and legal guardian of Raoul Wallenberg against the Soviet Union (Von Dardel v. Soviet Union). On January 28, 1987, you published an article by a private lawyer in California entitled "State Department Goes to Court For the Kremlin" commenting on the role of the Department in the Gregorian case. Both your editorial and the January 28 article contain a number of inaccurate and misleading assertions about the U.S. role in litigation involving foreign states.

Contrary to the suggestion in your editorial, the State Department is not representing the Soviet Union, or invoking sovereign immunity in its behalf either in the Gregorian case, or in the Wallenberg case. A cursory reading of the United States' submissions in both those cases would have dispelled immediately such erroneous notions. The role of the U.S. Government in these suits is strictly limited to that which the Executive has played in litigation against foreign governments in U.S. courts since Congress enacted the Foreign Sovereign Immunities Act (hereinafter referred to as "the FSIA" or "the Act"). At that time, while acknowledging that immunity decisions henceforth were to be made under the Act by the courts, the Department noted that the United States would maintain a continuing interest in the interpretation of the Act because of the foreign policy implications of its application, and would continue to comment on such issues where appropriate. See, Letter of Monroe Leigh to Attorney General Edward H. Levy, Nov. 2, 1976, LXXV St. Dept. Bull. 649 (1976). Since that time, the United States has repeatedly presented to courts in appropriate cases its views on the proper interpretation and application of the Act, and its impact upon the conduct of foreign affairs. Determinations of sovereign immunity are made exclusively by the courts, however, and not solely on the basis of U.S. Government representations.

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When it participates in litigation involving the FSIA, the United States does not appear on behalf of foreign governments. In fact, the United States actively seeks to convince foreign governments that they should appear and present any defenses they may have, including claims of sovereign immunity, directly to the courts. When we succeed in convincing them to do so, we have often asked the court involved to set aside default judgments and to hear their claims. This serves the interests of justice. Indeed, our courts have repeatedly recognized that default judgments are not favored and, whenever it is reasonably possible, cases should be decided on the merits. The courts have evidenced an even stronger presumption against default judgments in cases involving foreign states and the important principle of sovereign immunity. Courts have often vacated default judgments entered after a foreign country had initially failed to appear.

Decisions on the merits also favor the parties who sue foreign entities. Plaintiffs with meritorious cases are far more likely to recover when a foreign state has responded.

Some states refuse to appear in our courts, however, despite our best efforts. They believe they are absolutely immune from suit. In such cases, the court may be called upon to enter a default judgment. Although the FSIA prohibits the court from entering a default judgment unless the claimant establishes his claim or right to relief by evidence satisfactory to the court, the adversary system does not work in this situation as it normally would to ensure that the court has before it all the necessary arguments and facts. The court has before it only the arguments of one party. Under those circumstances, the United States may present its views at the request of the court involved, or because an issue being litigated is of significance to the application of the FSIA.

The United States became involved in the Gregorian case, in part, because counsel for Mr. Gregorian, Mr. Kroll, made repeated requests for assistance in getting the Soviet Union to respond to his suit. After discussion between the State Department and the Soviet Embassy, two of the Soviet state-owned commercial defendants agreed to retain private U.S. counsel to appear on their behalf and to file appropriate motions for relief. The United States has requested, in light of the appearances by these Soviet entities, that the court set aside the default judgment and consider the legal and factual

arguments of the Soviet defendants on the merits, meanwhile suspending enforcement. If the court decides to grant this relief, it may still enter a decision in favor of the plaintiff on one or more of Mr. Gregorian's claims.

Nor does the Department support the Soviet Union in dismissing the case. The U.S. Government has expressed its view that Congress did not intend in the FSIA to provide jurisdiction over libel actions. This is a general issue under the FSIA in which the United States has an independent interest. We have not submitted any views, however, on the contractual aspects of the dispute. Moreover, before the U.S. Government submitted views on the libel jurisdiction issue, I offered to meet with and try to assist Mr. Gregorian's attorney in resolving this case short of further litigation. My offer was declined.

In the Wallenberg case, the District Court entered a default judgment in November 1985 that directed the Soviet Union, among other things, to produce Wallenberg or his remains within 60 days and to pay 39 million dollars in damages. When the Soviet Union did not comply, plaintiffs filed a motion to hold the Soviet Government in contempt. Recognizing that entry of such an order would involve important foreign relations issues under the law, the Court specifically requested the views of the United States.

In response to the Court's request, the U.S. Government filed a Statement of Interest in which we informed the Court that the exercise of the contempt power in that case would be inconsistent with the purposes of the FSIA, and would be ineffective. We also advised the Court that it should not find the Soviet Union in contempt, because the Court lacked jurisdiction under the FSIA to enter its original decision. We noted in our response that the U.S. Government "abhors the Soviet Union's unjust imprisonment of Wallenberg and continues, through governmental channels, to seek a full and satisfactory accounting of his fate."

The decision of the U.S. Government to submit its views in litigation under the FSIA is based upon principled considerations of law and policy. These relate, not only to our bilateral relations with the Soviet Union, but also to our relations with all other foreign countries. Interpretations of those aspects of the FSIA upon which the U.S. Government has commented in the Gregorian, Wallenberg, and other cases, have general application to litigation under the FSIA involving other countries. What we do to other countries we should expect to be done to us within their systems. (The Soviet

Union, consistent with its view of international law, provides the United States far greater immunity than we accord foreign countries under the FSIA.) And, we must certainly act even handedly in matters involving justice in our courts. This means doing no more for the Soviets than we would do for another state, but also doing no less.

Sincerely,

Abraham D. Sofaer