

Executive Summary

Military export controls have been an element of American security since before the Second World War. Unfortunately, our military export controls have failed to keep pace with the new international security environment. The current system expends enormous resources on trivial and unimportant security risks, drives a wedge between the United States and its allies, and gives the illusion of protection by mechanical compliance with regulations rather than dynamic evaluation of risks. Faced with difficulties in securing licenses, foreign companies have given direction to avoid U.S. components where possible. The interoperability problems that plagued NATO during the air war in the Balkans will only get worse in years ahead.

With the arrival of a new Administration and a new Congress, the time is ripe to re-examine how to advance the full range of U.S. national security, foreign policy and economic objectives. Today we face challenges no less daunting than those of the second half of the 20th Century. The proliferation of weapons of mass destruction and delivery systems, the continuing scourge of terrorism and the deep-seated regional conflicts require continued American leadership, in coordination with broad-based multilateral efforts. American leadership, in turn, requires that we retain military forces second to none, as well as the strong economy needed to support them.

This challenge for arms exports takes place in a very different international context than was the case even a decade ago. Globalization inexorably spreads information and technology throughout an increasingly competitive world marketplace. The emergence of a global economy and declining arms budgets have greatly changed defense industrial production. In the past, the Department of Defense could depend on a dedicated domestic industrial base to develop and supply its equipment. DOD now depends on a broad, civilian industrial base which is less oriented to military production and which is increasingly global in character. Yet, despite these dramatic changes, our military export licensing process remains essentially the same as it was in the 1970s. Current controls are justified as a tool for diplomacy, but it is not clear how U.S. foreign policy benefits, for example, from taking eleven months to decide whether to sell Sweden a ground station or by requiring more than one hundred and thirty different licenses to authorize the sale of C-130s to the UK's Royal Air Force.

To confront these new challenges successfully, the United States must adjust its export control policy. The agglomeration of statutes, regulations and executive orders built up over decades and rooted in the Cold War framework is outdated and increasingly counterproductive for national security. It is slow, tangled in red tape and out of step with multilateral efforts. It is more than inefficient; the current process damages cooperation with our allies and weakens our ability to produce the necessary weapons, without effectively restricting access to technology by potential opponents. When the U.S. denies an export or hinders cooperation for technologies that have ready foreign substitutes, we turn potential partners into competitors.

We need a leaner and more effective export control system that: 1) narrowly targets exports of concern without needlessly burdening peaceful commerce; 2) strengthens the multilateral cooperation that is essential to any effective export control regime; 3) streamlines export classification, licensing and reporting processes; and 4) affords the President the authority and

flexibility needed to advance American interests.

The Center for Strategic and International Studies (CSIS) has undertaken a comprehensive analysis of how the United States should reform its export control regime for military equipment. The objective of this effort was to reassess the current export control framework and generate innovative changes in policies and procedures consistent with the realities of the twenty-first century environment. CSIS sought viable solutions to strengthening national security through relevant, realistic, and effective export controls.

CSIS sought to present innovative thinking as well as practical policy recommendations on the range of issues associated with military export controls. The essential features of these recommendations are: a) to replace licensing of low risk individual transactions with programmatic approvals; b) to establish timelines for decisions on those items which still require licenses; c) to streamline the munitions list through annual reviews; and d) to harmonize national and multilateral lists to eliminate jurisdictional disputes.

The key to reform rests in three new partnerships—a partnership between the governments of allied countries, between the government and industry, and between the many agencies involved in export controls. Streamlining the U.S. Munitions List and restructuring the Congressional notification process will reinforce these partnerships in ways that help build national security.

The first element of a new system rests with a new partnership between the United States and its allies and security partners to jointly supervise technology controls and export controls for transactions that occur between two countries. There is a model for a new system, derived from the International Trade in Arms Regulations (ITAR) waiver between the United States and Canada. This waiver allows the U.S. and Canada to exchange unclassified components and data without licensing, but both the United States and Canada monitor their respective borders to preclude subsequent export.

Countries that share effective security procedures with the United States would enjoy a greater degree of flexibility under the ITAR process and most of the transactions between the two countries could be governed by a waiver - licensing would be eliminated. It is important to note the incentives created in this system. Industrial partners between “waiver” countries would enjoy greater efficiency and have a competitive advantage in the market place. This could encourage potential industrial partners in other countries, in turn, to encourage their governments to work more closely with the United States to collaborate in the security and intelligence fields.

As part of this new partnership, the U.S. should examine its restrictions on reexports. Current regulations require that the re-export to a third country of any U.S. munitions items or technology, no matter how ordinary or small, requires a State Department license. This raises serious problems when a U.S. munitions item is incorporated into a larger foreign system. No other country has this requirement. Foreign companies had to accept this restriction when the U.S. was the only source for an item. Now that the U.S. no longer has a monopoly on many

technologies, there are many cases where foreign firms have ‘designed out’ U.S. components and replaced them with foreign equivalents for which re-export authorization is not required. It is time to limit reexport approval to items of military importance. Reexport approval would only be required for any item on the control list designated as Significant Military Equipment or only when the U.S. content of the reexport represented more than 25 percent of the foreign equipment’s stated value. The retransfer or reexport of any item designated as Significant Military Equipment should continue to require U.S. approval.

The second key to reform rests with a new partnership between the government and companies seeking to export goods and services. Under this approach, the U.S. would replace redundant and repetitive individual licenses with a robust interagency review of technology security considerations and a rigorous system of monitoring and enforcement to ensure compliance with export regulations. Companies would be authorized to export once military technologies had been released by the government for export and after government agencies determined that their internal procedures were effective and in compliance with export regulations and policies.

This approach emphasizes adherence to regulation. The U.S. needs comprehensive regulatory procedures that emphasize releaseability, disclosure, monitoring, oversight and enforcement to replace outmoded individual license requirements. These new procedures should involve regular inspection and auditing by the government of companies’ procedures and records and regular reports from exporters to agencies on their export activities. Companies should be required to implement screening procedures and to consult with the government before exporting to unknown or questionable parties. This process of monitoring and certification mirrors effective programs used today by most regulatory agencies such as the Securities and Exchange Commission and the Food and Drug Administration.

The third key to reform is a new regulatory structure for arms exports. This requires a stronger partnership between the administrative agencies or agency, law enforcement, customs, defense, and intelligence agencies. The U.S. should replace the ad hoc and informal processes that now govern munitions exports with clear procedures and timelines.

This new regulatory process is not the end of licensing. We believe that some transactions will still require licenses- major arms sales or sales of missile-related equipment, for example. The Commission believes that the time has come to subject the military export control process to explicit disciplines and procedures. In the past, when DOD could depend on a dedicated domestic defense industrial base, a lack of transparency, inexplicable delays and ambiguity did not put national security at risk. This world is gone. The model for the reformed military licensing system should be the interagency process developed by State, Defense and Commerce under the leadership of the NSC that is laid out in Executive Order 12981. The hallmarks of E.O. 12981 are transparency and accountability. It imposes discipline on the licensing process by requiring decisions within fixed periods and by making each agency aware of and accountable for licensing decisions. It creates a structure of interagency committees for dispute resolution, imposes appropriate timelines on the licensing process, and guarantees each agency the right to

full transparency and to have its objections heard at the highest levels of government before State approves a license.

The military export procedures should recognize and track the decisions made in the National Disclosure Policy process regarding the security of technology. This process makes the policy decisions on what military technologies can be released and to whom before State issues any licenses - the license is usually a mechanical repetition of this NDP decision. This redundancy can be eliminated. When the U.S. government decides that it is acceptable to sell a military system to another government, the Commission believes all the items logistically related to that system should be approved as a package, reflecting the policy decision to make the sale in the first place. The dozens or even hundreds of licenses State now requires for approved transfers do nothing for national security or foreign policy. A license to sell F-16s to a country should be a standing authorization that need not be re-engaged every time that country has to replenish its supply of spare parts or missiles, unless there is a qualitative upgrade to the components or subsystems that requires a subsequent security assessment. The U.S. would retain, of course, the ability to “turn off” the spare parts pipeline if the recipient ever posed a threat to U.S. interests.

As part of this licensing process, the Commission believes that the Department of State must retain the ability to postpone a decision for diplomatic reasons. Major arms sales involve substantial foreign policy or defense considerations and for these items, the Secretary of State should retain the ability to have these applications held for some specified period, with the concurrence of the President. These cases are infrequent, a small minority of all licensing cases. They usually involve major arms transfers to countries like Taiwan, Saudi Arabia or Turkey. State is appropriately concerned with the potential reaction of neighboring countries to these transfers. The process the Commission envisions would preserve the Secretary of State’s authorities to raise any serious policy issues with such transfers and would ensure that the focus of interagency debate would be on policy, not procedure.

A new partnership in government must also include the Congress. The foundation of our munitions export controls is the Arms Export Control Act. Congress has amended the AECA many items since 1976, when it became law, but the core of the legislation remains sound. This core entails transparency, Congressional oversight, and coordination of arms transfers with our foreign and security policies. Any new system should continue to emphasize these core elements. Congressional notification of major arms sales is an essential part of transparency and must remain one of the central elements of the U.S. military export control system. The problem is the informal notification process that often takes months to complete. Congress and the Executive branch should restructure the Congressional Notification process to emphasize transparency and predictability - in Congress as well as in agencies. When a member of Congress has a question or objection to an arms sale, this should be dealt with in an open fashion and not by a staff-level process of informal consultation.

The U.S. Munitions List is the source of many of the problems with current system. The U.S. Munitions List contains many commercial items that other countries treat as civilian goods.

Export Controls that Work in the 21st Century

State uses the “commodity jurisdiction” process to try to distinguish between commercial goods and munitions, but the process is often arbitrary and takes months for a decision. Commodity jurisdiction usually reflects bureaucratic turf wars more than real security concerns. The Commission believes it is important to make our national list and the process for managing it more rational and more efficient. A shorter, coherent U.S. Munitions List would improve national security by removing obstacles to defense trade cooperation with allies and security partners and, more importantly, by letting agencies focus their resources on safeguarding essential technologies and not the hodge-podge of items now on the list.

The Defense Trade Security Initiative begun in 2000 called for a review of the munitions list every four years. We believe that the entire munitions list should be reviewed over the next year. The Secretaries of State, Defense and Commerce must establish a process that would review the control list each year thereafter to determine if additional items warrant control, or if items currently on the list can be removed without harm to national security. This task is technically challenging, so the President should establish the appropriate advisory committees (in addition to those already in place at State and Commerce) to assist in this task. As a first step, to speed the process, the U.S. should amend its list to reflect the extensive technical reviews that have already occurred in multilateral export control regimes such as the MTCR or the Wassenaar Arrangement.

Building an export control system that will serve national security in the 21st century will not be an easy task, given the accretion of rules and bureaucratic prerogatives that currently surrounds the process. The consequences, however, of failing to reform, will be costly. Antique export controls will lead U.S. and European industry to drift further apart. More isolated national industrial bases mean, as technological change continues to accelerate, less competition and less innovation. This would ensure less interoperability and, potentially, a situation where our military no longer has the advanced technologies and weapons it needs to stay ahead of any potential adversary.

Reform will require the Administration and Congress to take a hard look at our current export control system, informed not by a sentimental wish to control the uncontrollable or by veiled efforts to protect bureaucratic turf, but by a hard-nosed analysis of where export controls can still make a difference. It should remove ineffective restrictions that fail to acknowledge how U.S.-based companies operate in a global marketplace. At the end of the day, we need to ask if the current system of multiple agencies with overlapping responsibilities for export really serves the national interest or if the U.S. would gain from consolidating the administration of this system into a single new agency.

In short, the only export controls that make sense are those that are *both* effective *and* critical to our national security. We should not shrink from taking the necessary steps (including broad organizational reform) that will assure that military export controls can succeed in performing vital functions, while ridding it of those shortcomings that increasingly threaten American interests.

CSIS Recommendations for Military Exports

- Create a broad waiver program for allies and friends who agree to shared principles on security and law enforcement.
- Eliminate duplicative reviews, by reducing licensing and by giving more emphasis to decisions made in the National Disclosure Policy process.
- Replace transaction licensing with a regulatory approach. Strong enforcement and compliance efforts would replace licensing for low-risk munitions exports going to safe destinations.
- Establish a de minimis threshold for reexports
- Revise the Munitions list through regular reviews, to remove commercial or obsolete technologies, and conform it to the multilateral regime lists the U.S. has developed.
- Reform the Congressional notification procedure, to focus on weapons systems and transfers that could affect our foreign relations. Replace the current informal notification process with formal reporting on future arms sales (similar to the “Javits” report) to ensure that Congress is fully informed.
- Create disciplines for munitions licensing - timelines, transparency, and procedures that guarantee default to decision while preserving the policy prerogatives of State and other agencies. Make the process focus on policy issues, not procedural problems.
- Undertake a Senior-level review of whether it would be better to assign responsibility for the administrative tasks for all licenses - State, Commerce, Treasury - to a single agency.

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Chapter I – Export Controls That Work In The 21ST Century

A Changing Environment Presents New Challenges

The United States regulates the export of military items to protect American technology from exploitation by potential opponents and to provide a tool for foreign policy.¹ Export controls became an important element of America's broader security program during the Cold War. America's strategy relied on superior military technology in U.S. and allied forces as a counterweight against the larger forces fielded by the Soviet Union and its allies. To maintain that qualitative advantage, the United States needed to protect its military secrets assiduously and to mount extensive and elaborate measures to prevent potential opponents from gaining access to that technical know-how.

Through the 1980s, the U.S. created an extensive architecture of control, integrated into a larger American strategy to stay ahead of potentially dangerous opponents. Export controls also became an important tool to prevent the spread of sensitive technologies to states of concern. Because of the fear of the spread of nuclear weapons, the United States and other countries created multilateral agreements to monitor and control the export of nuclear-related technology and equipment. This extended to chemical weapons, missiles and missile-related components.

During the past 10 years, three major developments have radically changed the context and significance of export controls as a tool of security policy. First, a far more complex environment has replaced the relatively tidy cold war alignment of friends and foes. U.S. Allies now fly Soviet-designed and manufactured combat aircraft. Allies enter into industrial partnerships with defense firms in Russia. The sense of ominous threat that bridged the tensions in the Western alliance has disappeared, resulting in allied countries openly undertaking commercial actions the Commission judges to be risky. In short, the security environment is now messy and unpredictable.

Second, the United States and other countries are adopting commercial products, manufacturing techniques and components for defense articles. During the past 10 years, the United States has tried to break the grip of a hothouse defense industry captured by government acquisition practices by adopting commercial business practices and products. During this same time, the defense industry has also adopted management practices that optimize the manufacturing process

¹During the Cold War, export controls developed along two principle lines. First, the control of military technology is governed by the Arms Export Control Act and managed by the Department of State. Second, the control of "dual-use" industrial technology is governed by the Export Administration Act and managed by the Department of Commerce.

by eliminating costly and cumbersome logistics systems. “Just-in-time” delivery of components, as well as finished products, has reduced production costs by eliminating expensive warehousing facilities and production overruns. In addition, the commercial sector does not labor under a cumbersome export control regime that requires a stamp of approval for every transaction. Rather, it has adopted a process-based system that operates in conjunction with our Customs Service. In short, while the Defense Department seeks commercial technologies and practices, it confronts unprecedented security problems as American business adopts global operations.

Third, the global economy has evolved in ways that were not envisioned when the U.S. established its export control program decades ago. Industrial activities are now routinely conducted through international partnerships, through either mergers or long-term strategic relationships. Companies routinely partner with foreign vendors, to take advantage of specialization, to spread the risk of development or to insure market entry for new products. One major U.S. company has design teams located around the world so that at the end of one team’s day, a problem can be handed to a design team in a different time zone that is just coming to work. The sun never sets on the design work of this company, demonstrating a model of business practice that many design teams now use. International partnering has become the norm, yet such international collaboration is seen largely as a security risk by the defense industrial security establishment.

Export Controls Now Increasingly Threaten National Security

Partnership with allies in the shared task of a common defense has been the bulwark of America’s security over the past fifty years. That cornerstone of security is now at risk thanks to an export control process that is driving a wedge between the United States and our allies. Plagued by difficulties in securing licenses, foreign companies have given direction to design engineers to avoid U.S. components where possible. The interoperability problems that plagued NATO during the air war in the Balkans will only get worse in years ahead, as the security procedures and export controls once designed to protect American security are increasingly the cause of security problems.

During the past 10 years, America has gone to war leading a coalition of countries. These coalition operations have uncovered security problems that result directly from the arms export licensing process. Operation Noble Anvil revealed serious interoperability problems. We prevented even our closest allies from buying state-of-the-art American equipment for fear of technology loss. When war came in the Balkans, we struggled to establish interoperable communications and procedures to bridge the technical impediments confronted by the coalition. One ally flew front line combat missions, but the United States refused to provide directly the same software used by U.S. aircraft. We adopted a jury-rigged compromise, where an American technician would install the critical mission software just before the allied pilots took off, and then download the software upon landing. Allied nations were forced to secure emergency licenses to buy equipment from the United States in order to continue to fly side-by-side with American pilots. The laborious export review process strained relations with our strongest allies

during the war.

The purpose of licensing military equipment appears to have gotten lost in the bureaucratic maze and has grown so cumbersome, complex, and slow that it is generating tensions with allies and friends, and degrading the competitiveness of the U.S. defense industry. The growing symptoms of this problem are compelling:

- ❑ In 1999, U.S. defense corporations submitted some 45,000 license applications to the Department of State. Ultimately, State approved more than 99 percent of the applications. However, the time it took to process these applications ranged from a few days to many months or even years. In a world of ever-shorter R&D, and production and marketing cycles, the delay in processing presents a profound disadvantage for U.S. defense companies.
- ❑ Frustration with the license approval system has grown so significant that a major European defense corporation has instructed its design engineers to exclude U.S. defense components from their designs to avoid problems with U.S. export licensing. The implications of such a directive for the U.S. defense industry are disturbing.
- ❑ Last year, 17 European ambassadors to the United States sent an unprecedented letter to protest the increasing difficulty of securing licenses from the Department of State. The letter underscored the negative effect of the export control regime on transatlantic defense cooperation, the collaboration of allies in developing new military equipment, and the sale of U.S. systems abroad (Appendix A).

Business practices highlight the problem. In numerous discussions, the Commission found that companies usually allot three to six months to get a U.S. munitions license, but only two to four weeks when getting a license for the same item from another NATO country. Security concerns during the past two years have dramatically worsened technical cooperation between U.S. defense corporations and counterpart companies in allied countries. Here are a few examples:

- ❑ About 20 months ago, the Canadian Government decided to drop Orbital Sciences Corporation, the winner of the Radarsat 2 satellite platform contract, and go with Italy's Alenia on the \$50 million effort, based on Orbital's difficulties in getting the export licenses it would need (Source, *Space News*, January 10, 2000).
- ❑ By the time a major electronics company received a State Department license to bid to sell electronic modules worth \$50 million for European commercial satellites, the exasperated spacecraft builder had turned to suppliers in Europe and Japan (Source: *Aviation Week and Space Technology*, May 24, 1999).
- ❑ The Director of the French aeronautic and space agency visited Washington last year to alert American officials that Ariane satellite launch dates were slipping because of inability to procure US parts. In meetings with US industry and government officials, the Director noted

that France had no choice but to adopt an official policy of avoiding American parts due to the lack of assurance that they can be obtained when needed (Source: Aerospace Industries Association).

- The Royal Netherlands Air Force needed digital maps of the Balkans on an emergency basis for their U.S.-made CH-47 helicopters to fly NATO support missions in Bosnia. DTC refused to allow the U.S. company to ship under the ITAR exemption for NATO countries and, despite repeated requests from the Netherlands Embassy and the U.S. company, took two months to approve the transfer. (Source: Aerospace Industries Association and Embassy of the Netherlands).

The reaction of our allies in NATO to these obstacles has not been one of passive contemplation. The governments of the six largest European arms-producing countries (Germany, France, Spain, Italy, the United Kingdom, and Sweden) have begun to integrate their defense industries. Their “Letter of Intent” process will build a more integrated European defense industry and market that will contribute to the creation of a common European defense and security policy. The Letter of Intent process has been complemented by the formation of the first major international arms-producing company: the tri-national (France, Germany, Spain) European Aeronautics, Defense and Space Company. While these actions reflect larger trends - the consolidation of defense industries in Europe and the efforts to forge an independent European defense identity - the effect is to create two separate defense industries and two separate technology bases, one for the U.S. and one for Europe. This development, exacerbated if not caused by military export controls, is profoundly contrary to our national interest in building stronger transatlantic linkages.

Current System Provides Inadequate Security

Worse yet, the current export control system provides inadequate security. Far too much of the resources and energy of the export control system is devoted to protecting obsolete technology, diverting scarce government resources away from far more serious potential problems. Most requests are for spare parts, old equipment or replacement components. One U.S. company spent half a year trying to get an export license for a 50-year old radiator for a military truck. The current licensing process is choking with paper applications for routine requests that represent no technology loss and are an insignificant risk to American security. The personnel and resources devoted to these applications could far better be devoted to potentially high-risk transactions.

Some argue that this merely calls for greater resources for the current system. More resources will not fix an increasingly complex problem. As the manufacturing process becomes increasingly international and as defense articles increasingly incorporate commercial components, the current system will only serve to further burden an already regulatory-bound acquisition process. The logical outcome of the current approach is less commercial viability to defense contractors, weaker collaboration with allies and even less interoperable forces. In the context of the dramatically changed (and changing) international security environment of the

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twenty-first century, a fundamental reassessment of the export control regime for military equipment is critical. America needs a new approach to export controls.

Chapter II – Making Arms Export Controls Serve National Security In a New Century

A new consensus on how to meet the challenges to national security must begin with agreement on the principles that should inform any effective system of export controls. The following broad principles are perhaps the most important for guiding the development of a new regulatory system:

Security. The ultimate goal of any export control system must be to advance U.S. national security. Since the end of the Cold War, a new international security environment has emerged, changing the requirements of how best to build America's strength and safety. Export controls must be based on a realistic and honest assessment of their contribution to U.S. security in a global economy where technology is increasingly international, collaborative and accessible.

Partnership. Export controls should be a tool and incentive for building and strengthening defense ties with key partners and allies as much as they are a means of restricting access to technology by potential opponents. This emphasis on inter-governmental partnership should be informed by the requirements of coalition warfare and multilateral cooperation on nonproliferation and security. The U.S. should commit the political capital and develop the relevant policies needed to restore U.S. leadership in the multilateral regimes. Constructive partnerships between the U.S. Government and industry as well as among government agencies are also critical to ensuring implementation of the most effective and efficient regulatory systems and processes.

Modernize. Export controls need to recognize a changing economic environment. Current export controls were devised when most U.S. defense manufacturing was highly localized and utilized government-unique components. Today the development process is transnational and the government is increasingly using commercial business practices and components. A new export controls system must recognize the nature of business today and institute regulatory practices that fit this business model.

Streamline. We need to adopt simplified, relevant and functional regulations and administrative processes, in line with the elements outlined above. Export controls should move from a system where each aspect of a transaction is reviewed and licensed, to a regulatory approach that relies on processed-based certification, auditing and accountability, threshold approvals, packaged licensing and programmatic compliance.

Designing an Export Control System for the 21st Century

The current system fails on three key points. First, it fails to distinguish adequately between high-risk technology transfers and mechanical compliance with government rules. The system is choking on large numbers of applications for routine technology going to friendly countries. The Commission supports one of the key recommendations of the Cox Commission, which calls for “higher fences” around a very much smaller set of critical technologies and components. However, building higher fences is only half of the task - we also need to control “fewer goods.”

Second, the current system fails by requiring licenses going anywhere outside of the United States (with the exception of Canada) whether to our strongest allies or to the most problematic destinations. A new system needs to ease the burdens of licensing where the risk of technology compromise is low and the tools for sharing security burdens are ample.

Third, the current system fails by making little distinction between cutting edge military technology and commercial or even obsolete equipment. Licenses are required for 30- year old components and for new systems just now on the drawing boards. A modern export control system needs to distinguish between the cutting edge and the ordinary. The current regulatory approach is static. It fails to address the dynamic nature of technological change where advanced technology today can be commercially obsolete within a few short years.²

Establishing an International Consensus for Multilateral Controls

Multilateral agreement on arms export controls has been sporadic at best over the last decade, despite U.S. efforts to advance it. COCOM, the ancient regime of export control for NATO allies, dealt with industrial goods, as no COCOM partner was willing to sell arms to the Soviets. COCOM did not control arms sales beyond the Warsaw Pact, and members transferred arms to Iraq, India, Pakistan and others without any effort at coordination. The Wassenaar Arrangement, COCOM’s successor, has paid more attention to arms transfers and had some success in blocking arms sales to Iran. However, the consensus that sustained an arms embargo for Iran or Libya in the 1990s is eroding.

We need to find ways to strengthen multilateral cooperation. This is a difficult task, because cooperation requires a degree of synchronization in foreign policies that is rarely achieved absent a clear threat. At the end of the day, if multilateral cooperation is not possible the U.S. will need

² Some proliferation technologies, even though obsolete, will still need to be controlled. Techniques for making nuclear weapons may be obsolete in the West, but dangerously useful to small countries. These risks are important, but few in number, and should continue to be controlled even if the technology is judged obsolete.

to protect unilaterally its unique military technologies, but this protection should not be overextended until it becomes an obstacle to strengthening our alliances and our defense industrial base. A balanced approach is needed. When the U.S. denies an export or hinders cooperation for technologies that have ready foreign substitutes, we turn potential foreign partners into competitors. For those military technologies where we do not have a unique advantage, we are better served by expanding technology transfer to encourage closer ties.

New Partnerships Are The Key To Effective Export Controls

The key to reform rests in three new partnerships—partnerships between the governments of allied countries, between the government and industry, and between the national security and law enforcement agencies. We will discuss each in turn. Building the military export control system around these partnerships will take into account both the closeness of security ties with the U.S. in one instance, and the sensitivity of technology in the other.

Chapter III – Partnership Between Allied Governments

The export control system of the past was grounded in the control of individual national governments over industrial activity with its political jurisdiction and in trade with entities in other countries. The emergence of transnational business practices and industrial partnerships require a new model of government oversight.

The first element of a new system rests with a new partnership between the United States and its allies and security partners to jointly supervise technology controls and export controls for transactions that occur between two countries. The model for this new system is the International Trade in Arms Regulations (ITAR) waiver between the United States and Canada. This waiver allows the U.S. and Canada to exchange unclassified components and data, but both the United States and Canada monitor their respective borders to preclude subsequent export.³

A brief review of the origin of the ITAR exemption is important to understand its role as a model for reform. The U.S. and Canada established a waiver program in 1940. At the time, the U.S. and Canada realized that a significant degree of economic integration between the two countries had already occurred, and recognizing this would enhance both nations' security interests. Indeed, in formal acquisition regulations of the Department of Defense, Canada is included in the American industrial base. The waiver allowed an American company with a subsidiary in Canada or a Canadian company with a subsidiary in the U.S. to move goods and data without impediment so long as this was internal to the company's own manufacturing process. Once the commodity left either Canada or the United States, normal licensing was required. The Canadian waiver was a herald, foreshadowing the internationalization of manufacturing processes and business models used today.

While integration of the Canadian and American economies was a key component underlying the ITAR waiver, the long-standing, intimate collaboration between U.S. and Canadian law enforcement and national security agencies is equally important. The United States and Canada work closely together in the area of law enforcement, intelligence, customs, and national defense. This underlying security collaboration was just as crucial as the economic integration in contributing to the ITAR waiver for Canada.

³ The State Department modified the Waiver on March 30, 2001, but the general principles still serve as a useful model.

If our defense industrial base is to remain healthy and competitive, we must recognize the increasing internationalization of American business. The policy decision to adopt commercial products and business practices to defense acquisition necessitates adapting the ITAR waiver model to the larger process of technology security and export controls. To that end, two years ago the Department of Defense entered into a “declaration of principles” with the Ministry of Defense in the United Kingdom. That declaration of principles outlined how the two ministries would collaborate to provide technology and industrial security, thus setting the stage for extending the ITAR waiver to the United Kingdom. This extension represents the foundation for a new military export control system that matches the globalization of business in this decade.

Currently, U.S. and U.K. negotiating teams are working through the details of a formal agreement, but absent changes to the U.S. system (in licensing, technology and re-exports), the U.S. will not reap the full benefit of a broad waiver. These obstacles suggest that the ITAR waiver process must be reassessed. Presently the system is inflexible and conflict-prone. It has been a sparring ground between the United States and Canada in recent years. The U.S. believes that Canada has disregarded key security features central to the waiver. Canada believes that the United States has imposed American policy preferences on Canada, despite its sovereign right to decide its own foreign policies. There are two paths to overcoming these obstacles. The first path would attempt to define ever-more elaborate rules and regulations to adapt today’s regulations to tomorrow’s business activities. We have tried this path and it has failed to build stronger alliances or protect technology. The other path is to take a fresh approach to assess risk and to share that risk between two countries with fundamentally complementary national policies and objectives. Where there are differences, rigid licensing can remain. However, most export transactions are not controversial and could be exempted from licensing. Further, such an approach would also improve interoperability and strengthen efforts for burden sharing by building allied coalitions.

The Declaration of Principles offers the possibility for broad integration of defense industries with America’s allies along the lines of the Canadian ITAR waiver. The U.S. has outlined a set

Export Procedures

As stated in the Declaration of Principles

The participants (U.S. DoD & U.K. MoD) will:

- ❑ **Explore approaches to achieve greater transparency & efficiency**
- ❑ **Explore means of simplifying the procedures for export of defense articles and services**
- ❑ **Ensure that their national laws and regulations for defense exports to third parties are implemented in a spirit of cooperation and with maximum efficiency**
- ❑ **To harmonize their conventional arms export policies as far as possible**
- ❑ **Establish a high-level council on export control and coordination measures**

Partnership Between Allied Governments

of conditions that other countries would need to meet before this approach can be extended to them. These practices would include membership in multilateral export control arrangements, such as the Missile Technology Control Regime and the Non-Proliferation Treaty; harmonized control lists; regulations and procedures comparable in effectiveness to the U.S.; requirements for U.S. government approval of re-transfer or re-export of sensitive defense articles and related technical data of U.S. origin, and; rigorous screening of personnel and entities participating in defense manufacturing and trade. Additional information on the Declaration of Principles is found in Appendix B.

In addition, the U.S. would look for documentation and record-keeping requirements for companies to allow for compliance and enforcement; strong criminal and civil penalties for export control violations; cooperative enforcement efforts; regular consultations on export control policies and practices, and finally; a demonstrated system of effective export controls. When the President determines that these are place, the declaration of principles and the ITAR waiver process can and should be extended to countries that have close security collaboration with the United States. Countries that share security collaboration procedures with the United States would enjoy a greater degree of flexibility under the ITAR process and almost all of the transactions between the two countries could be governed by a waiver - licensing on unclassified items would be eliminated.

It is important to note the incentives created in this system. Industrial partnerships between “waiver” countries would enjoy greater efficiency and have a competitive advantage in the market place. Using these conditions as incentives for partnership, rather than obstacles to agreement will ensure that partner nations’ export controls and technology security practices are comparable to those of the United States. This could lead potential industrial partners in other countries in turn to encourage their governments to work more closely with the United States to collaborate in the security and intelligence fields.

Chapter IV- Partnership between Government and Industry

The second key to reform rests with a new partnership between the government and exporters. The current process is adversarial. It lacks transparency in the government decision-making process. There is no reliable method for industry to determine in advance the problems they might encounter when they submit a license or the reasons for its rejection. There are no specified timelines for action by the government. A “problem” can delay a license for months on end while the company representative struggles to find out why the application is being questioned or what needs to be done to address the security concerns. The current process is paper-bound. Other regulatory agencies have confronted and overcome these problems. We can do the same for military exports.

License Process Not Transactions

We need a new process that reinforces a company's export control compliance system. Company compliance with export regulations is the first line of defense for technology security. Under this new approach, the U.S. would replace many duplicative individual arms export licenses with broad programmatic and package licenses. Currently a license is required for each sale or “transaction.” Many of these licenses are redundant, often mechanically repeating earlier reviews and decisions. For example, one company reports that it needed one hundred and thirty six licenses for the sale of propeller-driven cargo Aircraft to the United Kingdom. More licenses will be required to support the Royal Air Force in the future. Similar stories abound for F-16 sales to NATO members and for other platforms. There is no foreign policy or national security benefit to the United States from this multiplicity of redundant licensing.

Adapting business process reforms to licensing offers great promise for improved efficiency and stronger security. During the past decade, a new approach has revolutionized quality control in the manufacturing sector. In an earlier time, companies posted quality control experts at the end of production lines and randomly sampled the product coming off the production line to see that it met specifications. Quality control in the modern manufacturing process entails continuous monitoring of the key manufacturing statistical indices to insure that the manufacturing process designed to produce perfect products remains in place.

Japanese manufacturers introduced a new approach where quality control was seen to be the product of exacting attention to the manufacturing process itself. If the manufacturing process were properly designed and appropriate statistical measures were kept on sub-processes, every item coming off the production line would meet the specifications without spot-checking.

We need to adapt this system used in quality control (a comparable system has been developed

for auditing financial records) to the export control process. Under this new process licensing system, the government would audit and approve a company’s export compliance system itself, rather than approve each export transaction. The government would audit the company’s internal controls, and if those controls were judged to be acceptable, the government would license the company to export under specified conditions with no further licensing required for individual sales.

Obviously, there would be approval conditions on the process license. The new system would encompass decision rules that accommodate the sensitivity of the technology and the risk associated with the trading partner. The following table outlines one approach to the approval conditions for process licenses.

“Riskiness” of Recipient Country/Company

	High Risk	Medium Risk	Low Risk
Obsolete Technology	Transaction License	Process License	Process License
Current Technology	Transaction License	Transaction License	Process License
Future Design	Prohibited	Transaction License	Process License

For example, if an American company wants to share current technology with a low-risk trading partner, the U.S. would permit the company to do so without further license applications so long as it has a government-approved export control system in place. A proposal to share future-design technology or components with a medium-risk trading partner would still require individual licenses for each sale or “transaction.” The government would establish criteria for deciding how to categorize technology and trading partners into these broad categories. The government regulatory process would emphasize the assessment of risk in trading partners and reviewing the sensitivity of the technology.

This procedure is already in place with the “National Disclosure Policy” process managed by the Department of Defense (State chaired the process until the 1970s, when it shifted responsibility to DOD to ensure more timely decisions). State is a participant in NDP decisions, and the Secretary of State has the ability to hold decisions when there are compelling foreign policy concerns. The national disclosure process distinguishes the risks associated with trading partners in deciding whether or not it is safe to release classified information and technology. The ITAR needs a similar differentiation process and in general, the military export system would benefit from aligning itself more closely to the NDP process- once an item has been released to a country by the NDP process it should not need a second review and a license for export.

This process of monitoring and certification emphasizes *regulation* rather than *licensing*. It mirrors effective programs used today at agencies as disparate as the Securities and Exchange

Commission and the Food and Drug Administration. In effect, the U.S. would be licensing processes rather than transactions. Process licensing would require ongoing inspection and assessment by government auditors, but it holds the promise for substantially modernizing the export control process. More importantly, it expands the enforcement community for export controls by making company compliance officers our allies in the export control process. The regulatory approach emphasizes disclosure, monitoring, oversight and enforcement. The new procedures should establish accountability and contain substantial civil and criminal penalties for noncompliance. Substantial penalties are an essential element of compliance in a regulatory system and any reform would need to assess carefully whether the penalties now in place are sufficient.

Under this approach, some items -- weapons systems and missile production equipment, for example -- would still require licenses and these items should be subject to the unified licensing procedure described below. For all other munitions exports, the U.S. should develop

National Disclosure Policy

Disclosure of materials is made only when all of the following criteria are met:

- Disclosure is consistent with U.S. foreign policy and national security objectives regarding the receiving foreign government
- Disclosure is consistent with U.S. military and security objectives
- Foreign government will afford the same degree of security
- Disclosure will result in a clearly defined advantage to the U.S.
- Disclosure is limited to information necessary to the purpose for which disclosure is made

comprehensive regulatory procedures in lieu of individual license requirements. These procedures should entail regular inspection and auditing by the government of companies' procedures and records and regular reports from exporters to agencies on what they have exported and to whom. Companies would be required to implement screening procedures (similar to those required by the Enhanced Proliferation Control Initiative) and new regulations would be needed to create a requirement for consultation with the government before exporting to unknown or questionable parties.

Rather than relying on licenses, agencies should work in advance to identify potentially suspect transactions and to notify companies to be on the watch for purchase requests from potentially suspect buyers or for transactions that are counter to larger U.S. policy interests. The U.S. has started to establish such a system with the signing by the Defense Department, the Justice Department, FBI, and the Central Intelligence Agency of "CI-21," a blueprint for counterintelligence in the 21st century. Under this approach, which seeks to identify risk areas and address them before an incident occurs, we could reallocate resources now dedicated to redundant licensing to compliance activities. This reallocation would strengthen U.S. export controls.

Package Licenses

Currently, when the U.S. government authorizes the sale of a new weapon system to a country, subsequent licenses are required for sale of support equipment, for technical manuals and publications to maintain it, for software packages needed to operate the system, spare parts, et cetera. This was not a problem when most transfers to allies occurred under the government-to-government Foreign Military Sales (FMS) Program, where constant licensing and re-approval was not required, but as more arms sales are made under State's munitions licensing, it has become a serious obstacle.

The Commission believes that the current licensing process should recognize and track key U.S. policy decisions. The vehicle for this should be the National Disclosure Policy process. This process weighs the risk of transferring military technologies to different recipients and sets clear guidelines for what can and cannot be transferred. When the U.S. government decides that it is acceptable to sell a system to another country, the Commission believes all the items logically and logistically related to that system should be approved as a package, reflecting the policy decision to make the sale in the first place. A license to sell F-16s to a country should be a standing authorization that need not be re-licensed every time that country needs to replenish its supply of spare parts, unless there is a qualitative upgrade to the components or subsystems that requires a subsequent security assessment. The U.S. would retain, of course, the ability to "turn off" the spare parts pipeline if this were to become necessary.

The basis for decision on package licenses should rest with the National Disclosure Policy. The NDP process distinguishes the risks posed by transfers of various levels of military technology in deciding whether or not it is safe to release classified material. The ITAR can use a similar differentiation. Once an item has been released to a country by the NDP process it should not need repeated reviews and licenses for export.

Explicit Process For Technology Risk Assessment

A new export control system will require an explicit process for technology risk assessment. The centerpiece of the current military export control system is the "U.S. Munitions List." The munitions list contains all those items that require a license before the item can be exported. Some estimate that the USML exerts jurisdiction over nearly 10,000 items. Many of the items on the munitions list do not represent technologies that are sensitive or unique to the U.S. President Bush ordered the last full review of the list in 1990. There is no comprehensive process for reviewing and updating the munitions list; the current approach is episodic, irregular and performed by the export control bureaucracies instead of technical experts. More important, there is no differentiation in the munitions list between items judged to be critically sensitive and those judged prosaic.

A considerable part of the problems the U.S. has in managing its control list arise from our

unique national approach, which guarantees a level of discord with allies. The USML contains many items that other countries, at our behest in multilateral negotiations, regard as commercial goods. When combined with the practice at State and DOD to declare that if an item is a munition, all its parts and components are also munitions, the result is that the USML contains a large number of commercial items, dual-use items or even obsolete items. Since they are on the munitions list, the U.S. requires an individual license for their export. This requirement generates hundreds of extra licenses without any benefit to national security or foreign policy.

The Commission believes it is time to better manage the munitions list. The ad hoc and arbitrary nature of the U.S. list has become a significant burden for exporters, with agencies often taking months to decide how an item should be controlled and licensed. It is also becoming an impediment to closer transatlantic defense cooperation with NATO allies. The process for a decision, called a “commodity jurisdiction,” is unnecessary and reflects administrative confusion and bureaucratic turf wars more than real security concerns. No other country has this complex interagency procedure or the many problems it creates.

We believe that two steps are needed to fix the USML. First, as a starting point, the U.S. should administratively adjust the USML to contain only those items found on the International Munitions List it has agreed to with its allies and nonproliferation partners. Conforming to multilateral precedent is an immediate step that would bring immediate relief. It would remove many of the major obstacles to concluding cooperative agreements with European allies and would eliminate most of commodity jurisdiction issues. Second, the U.S. should immediately begin a robust review of the USML by technical and military experts (and not by export controllers). This review process would give the U.S. the opportunity to expand the International Munitions List to include sensitive military items that may not currently be on it. We believe that this is likely to be a small number of items at best, but a regular review to ensure that the USML remains current is essential, and this must be accompanied by an U.S. effort in the multilateral regimes to get our allies to agree also to control any new munitions items.

This proposal explicitly models the process put in place by President Bush in August 1990, when he vetoed the Export Administration Act passed by the Congress. That process sought to harmonize the USML with the multilateral lists, excepting only the most sensitive items. The chief problem with that process was that it was entrusted to the export control bureaucracies at State, Commerce and Defense. Their work was slow and incomplete. The Defense Trade Security Initiative, announced by the White House in 2000, called for a review of the munitions list every four years. This is a useful, but given the parlous condition of the munitions list, it would be better to accelerate this process. To jump-start this process, we should take it out of the hands of the bureaucracy and give it to a Presidentially-appointed review commission consisting of government and private sector technical experts (perhaps under the auspices of the Defense Science Board or a Federally Funded Research and Development institution) to review the munitions list over the next 12 months.

Beyond this, the Secretaries of State, Defense and Commerce must routinize the review process,

to determine if additional items warrant control, or if items currently on the list can be removed without harm to national security. This task is technically challenging, so the President should establish the appropriate private sector advisory committees (beyond those already in place at State and Commerce) to assist the Departments in this task. As part of the review process, the Department of State should propose in the relevant multilateral regimes any changes to multilateral lists suggested by the U.S. review. Instead of vague political guidelines (“continued control contributes to the foreign policy and national security interests of the United States”⁴), the review should use robust technical and military criteria.

The Commission seconds the recommendations of the Defense Science Board’s Task Force on Globalization to establish a continuously updated list of essential military capabilities and an interagency database of globally available, militarily relevant technologies and capabilities. This database would allow those involved in the export licensing to determine the degree of sensitivity and risk associated with a particular transfer, and make modernization of the munitions list a routine event rather than a quadrennial exercise.

The treatment of technical data will be an especially difficult issue for the list review. The high end of technology is particularly sensitive, and the most sensitive military technologies are classified. The State Department, however, applies its technology controls in a blanket fashion, catching both the high end and the low. The State definition is:

Information, in any form, which is directly related to the design, engineering, development, production, processing, manufacture, use, operation, overhaul, repair, maintenance, modification, or reconstruction of defense articles. This includes, for example, information in the form of blueprints, drawings, photographs, plans, instructions, computer software and documentation. This also includes information that advances the state of the art of articles on the U.S. Munitions List⁵.

This broad reach covers too much and sometimes defies common sense. One European company told us, for example, that when it sends technical data to a U.S. partner, the U.S. partner needs a license to send the same data back, even though it originated with the European company.

The marked increase in the number of Technical Assistance Agreements required by State for Technical data over the last few years is evidence of this overreach. TAAs are long, contract-style documents, often comprised of dozens or even hundreds of pages, which list explicitly what, can be exported. This rise reflects the significant shift in the design and manufacturing process to reflect trans-national business relationships. While the overall number of export licenses has remained relatively the same since 1994¹, the number of manufacturing license

⁴ DTSI

⁵ ITAR

agreements and technical assistance agreements within that overall number has risen steadily each year since the mid-1990s (Figure 1).

The growing complexity of the international trade environment explains part of this increase. With the number of joint ventures, co-production operations, and offshore assembly arrangements growing exponentially over the past few years, it has become increasingly difficult to adequately keep watch over all of the items and services deemed significant by an outdated U.S. Munitions List. It is clear that the current system is incapable of effectively scrutinizing the transactions of over \$46 billion in defense articles and services.

Obtaining a TAA is a lengthy process, often involving complex, lengthy negotiations that result in inflexible agreements that are difficult to interpret. This difficulty creates a high degree of risk for anyone planning to partner with a U.S. company, and NATO allies have told us that it can deter them from buying from or cooperating with the U.S.

While the most sensitive technologies require strict protection, the U.S. needs to reform the current system so that it can distinguish between sensitive and routine.

The ITAR waiver, process license and package license approach the Commission has recommended would do this. All classified technology should require a license for export. The Executive branch can replace most of the licensing of exports of technology and defense services with appropriate regulatory procedures that will audit and certify that companies have effective internal control procedures to ensure compliance with arms export regulations and policies.

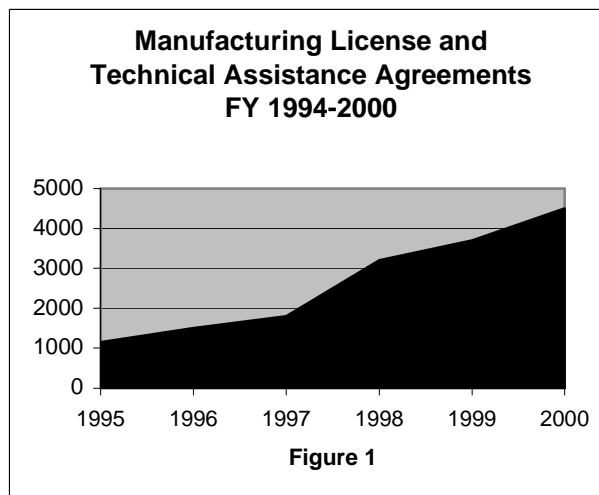


Figure 1

Reexport Approval Requirements

Current regulations require that the re-export to a third country of any U.S. munitions items, no matter how small or no matter if it is merely a small part of a larger, foreign built system, requires a State Department license. This raises serious problems when a U.S. munitions item is incorporated into a larger foreign system. Under State's rules, if a German company inserts a \$15 dollar U.S. munitions item into its \$150 million satellite, that satellite becomes a U.S. munitions item and requires a license from the U.S. for any sale. Other countries do not have the re-export requirement that the U.S. imposes. The U.S. no longer has a monopoly on many technologies, and the Commission knows many cases where foreign firms have 'designed out' U.S. components and replaced them with foreign equivalents for which re-export authorization is not required. This situation has led some to call for an end to re-export requirements, either for all countries or at least for NATO and major non-NATO allies.

We think it would be better to limit reexport approval to items of military importance. In this approach, reexport approval would be required for any item on the control list only designated as “Significant Military Equipment” or only when the U.S. content of the reexport represented more than 25 percent of the foreign equipment’s value. The retransfer or reexport of any item designated as Significant Military Equipment should continue to require U.S. approval. This procedure was developed by the Reagan administration for industrial goods and has worked well for many years. Changing the re-export requirement is essential for removing the most significant impediment to increased transatlantic defense industrial cooperation. This approach would mean that while routine items would be released, all U.S. weapons systems and sensitive technologies would still require our approval for any resale.

Chapter V- Partnership Within The Federal Government

The third partnership required for the new era of security challenges is internal to the United States Government. The new trans-national business model is straining the oversight functions of government agencies today. Agencies are trying to adapt their standing procedures to attempt to match new business practices. The transnational nature of American business is now blurring the administrative and oversight jurisdictions of various government entities. New patterns of collaboration are necessary.

A House Divided

America's federal government grew and expanded dramatically during the 20th century. When the century began, America was a nation still moving largely through the muscle power of people and animals. The century ended with space shuttles and routine trans-continental business travel. The government evolved to embrace new developments, yet kept the overall structure of the earlier era. The Federal Government is still dominated by large Departments—the departments of Agriculture, State, Treasury, Commerce, and Defense, all of which had direct antecedents back to the 19th century. To be sure, new technical developments—the invention of the radio, for example—led to the creation of new government entities, such as the Federal Communications Commission. Nonetheless, American government at the turn of the century is marked by large departments with set jurisdictional responsibilities that grew out of historical circumstances and developments.

The challenge of governance in this new decade is to bridge the boundaries that separate the constituent elements of the government. Each department seeks to embrace new technical and policy developments by expanding existing jurisdictions and activities to encompass these new developments. Inevitably, competing perspectives and jurisdictions clash, necessitating an interagency reconciliation process increasingly run from the White House.

Nowhere is this more vivid than in the area of export controls. Computer encryption software is a good case in point. When the government confronted the pressure to regulate encryption software, six departments claimed an active role in governance—the Department of State, the Commerce Department, the Justice Department, the Defense Department, the National Security Agency, the Federal Bureau of Investigations, and the Office of Management and Budget. All six entities had to meet in a White House-led interagency process to try to craft a new consensus policy to govern the export of encryption.

This is not a unique case. Routinely, representatives from the State Department, Commerce Department, and Defense Department, review applications and meet to reconcile differences

when new dual-use license requests come to the government. Each department maintains its own separate and unique internal procedures, and jealously guards its prerogatives in the interagency process.

It should be said that there is strength in this process, in that it insures that the competing dimensions of public policy are fully aired in the interagency review of applications. In the case of encryption software exports, some of the most important values of American society were in conflict. The encryption software represented a market opportunity for America's software industry that has fueled much of the productive growth of our economy in this past decade. Yet, encryption in the hands of criminals and spies could substantially blunt the ability of our security organizations to protect American society. At the same time, Americans have become increasingly anxious about their loss of privacy in an increasingly computerized economy and see encryption as a basic means to protect confidentiality. All of these important values needed to be balanced in the consideration of a new policy. A contentious inter-agency review process assures a full airing of these divergent imperatives.

It also must be said that much of the interagency review process is about bureaucratic politics, the struggle of agencies to protect and advance their institutional turf. While the battle may be waged on substance, the objectives of the battle are often the bureaucratic standing of the participants. While this is understandable, it is also understandably frustrating to those who must wait for the interagency process to reach either a compromise or a stalemate. At times, the battle will take years. Our review of the process leads us to the conclusion that bureaucratic prerogatives drive too much of the current military export control system.

Frustrated by the seemingly endless deliberative process, American companies increasingly locate manufacturing operations overseas in order to avoid the licensing nightmare. Foreign companies increasingly avoid American components, fearing an uncertain delay in gaining permission to even evaluate U.S. products. For example, during the past year, the U.S. satellite industry has lost a portion of its market share because of the bureaucratic snafus in the State Department-administered licensing process. Equally important, the current State-licensing process has badly damaged the subcontractors who provide the essential parts and components of satellites – the U.S. is now more dependent on foreign sources of supply for crucial components than before State was placed in charge.

Features of a New License Review Process

The new administrative structure for export controls should embrace the following principles in a new system of regulations.

Transparency. The new regulatory process should embrace full transparency of administrative status. While the government should have the right to confidential decision-making, there should be full transparency in the recommendations that were made the factors that led to that decision. Applicants should have access to the status of and agency views on their license

applications.

Default to decision, not to stalemate. Currently the license review process can continue for months and even years with no action because there is no mechanism in the regulations to force resolution. Bureaucracies can “win” by doing nothing. The Commission believes the preferred approach is to presume approval in the face of silence after a designated period of review. This will force agencies to register in writing their concerns. This would be accompanied by an explicit process for reporting agency positions and providing opportunities for license applicants to address the concerns of departments.

Accountability. At each level of license review (from office director to Cabinet member), a named individual should be accountable (both for the process and the outcome) for each license application.

Interagency Dispute Resolution

Interagency disputes are common in export controls. Munitions exports do not have a formal process for resolution of these disputes. State Department licensing officers have considerable discretion in license processing. In theory, this discretion allows the Secretary of State to ensure that arms exports are coordinated with foreign policy; in practice, the discretion authority is exercised by the licensing bureaucracy on a range of times, most with no implications for foreign policy and without the knowledge of the Secretary or any other senior official. The lack of a formal process gives State licensing the appearance of being arbitrary and capricious.

Open, explicit disciplines and procedures need to be applied to the munitions license application process. The Commission does not believe the Government should face an absolute deadline for approval, but it should be obligated to explain clearly within a specified period what reservations it has if any with the approval of a sale. In a different world, we could tolerate the costs of a lack of transparency, inexplicable delays and ambiguity. This world is gone. The model for the reformed system should be the interagency process developed by State, Defense and Commerce under the leadership of the NSC that is laid out in Executive Order 12981 (see Appendix C). E.O. 12981 was signed in December 1995, after months of interagency discussion. Its hallmarks are transparency and accountability. It imposes discipline on the licensing process by requiring decisions within fixed periods and by making each agency aware of and accountable for licensing decisions. It creates a structure of interagency committees for dispute resolution, imposes appropriate timelines on the licensing process, and guarantees each agency the right to full transparency and to have its objections heard at the highest levels of government before a license is approved.

The bureaucracy will argue that the license procedures developed for dual-use and proliferation related industrial equipment is inappropriate for military exports. It is clear from our investigations, however, that the review process for licensing is remarkably similar among all agencies: applications are received, they are staffed out to other agencies for review; agency

positions are collected and depending on the agency, a decision is made in weeks, months or years. The true root of any objections to using E.O. 12981 for arms exports will be the normal bureaucratic reluctance to give up prerogatives and the discretion to make decisions in an arbitrary and untrammled fashion.

As part of this new process, it may also be useful for the Secretaries of State and Defense to establish a high-level advisory council that provides an independent voice to the Secretaries outside the license review process itself. The Secretaries have the right and the responsibility to decide these matters, not mid-grade action officers. Ultimately these advisors only provide an independent assessment to the Secretaries who alone bear the responsibility for deciding how to proceed.

Transparent Government Review Procedures

Transparency should be a central element of the military export process, but it is not a feature of the current system. Transparency is essential both for good government purposes and for ensuring that military exports are consistent with the U.S. national interest. The lack of transparency in the current system is one of its most troubling features. The current process has changed little since the 1930s. Companies have to use informal contacts or high-level meetings just to determine the status of a license and what problems, if any, it presents to the government.

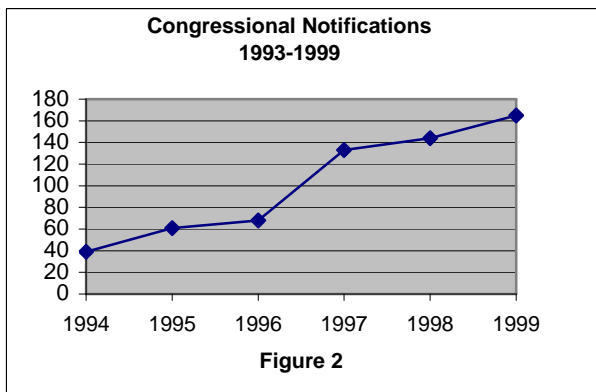
The foundation of our munitions export controls is the Arms Export Control Act. Congress has amended the AECA many items since 1976, when it was signed into law, but the core of the legislation remains sound. This core entails transparency, Congressional oversight, and coordination of arms transfers with our foreign and security policies. The Commission believes any new system should continue to emphasize these core elements. The AECA requires that arms sales above certain dollar thresholds be notified to Congress thirty days before the approval of any export (fifteen days for NATO Allies). In addition, the Executive branch and the Senate agreed, after the AECA was passed, to consult informally twenty days in advance of submitting a notification (a compromise provided by State to the Senate in exchange for not amending the AECA to use legislative days rather than calendar days).

Since the end of the Cold War, the number of licenses requiring notification to Congress has jumped dramatically. This increase is counterintuitive, as the value of U.S. arms exports has declined in the same period. In part, the increase reflects the failure to adjust notification thresholds to account for inflation, leading to a de-facto expansion of Congressional oversight. There are differing views as to whether this expansion is a good thing, but there is little debate that the notification process has become unpredictable and slow. The Commission has found that most companies allot an additional three to six months to the license approval process when Congressional notification is required.⁶

⁶ Poll

Much of this additional delay is the result of a process that has grown up over the last decade. State can wait weeks or months before actually submitting a notification and starting the 15 day/30-day Congressional clock. State will sometimes delay this informal consultation with committee staff if it believes that conditions on the Hill are not propitious. This is the source of most of the problems with notification. Our goal is to find ways to provide Congress with the information it needs while returning to the required process of 20 days for informal consultation and 15 or 30 days for formal notification.

Congressional notification of major arms sales is an essential part of transparency and should remain one of the central elements of the U.S. arms export control system. However, the Commission thinks that the Congressional Notification process should be restructured to



emphasize transparency and predictability - in Congress as well as in agencies. When a member of Congress has a question or objection to an arms sale, this should be dealt with in a transparent fashion as envisioned in the AECA. We believe that the goal of congressional notification - to ensure that Congress is not surprised by and does not oppose a proposed arms transfer - can be obtained by the use of transparent, predictable mechanisms in place of informal consultations.

An improved notification system could build upon existing reporting requirements. The model should be the “Javits” report, an annual report of possible arms sales. Some of the sales reported in the Javits report do not occur, others are postponed, but Congress is kept fully informed in advance of any transfer. Most of the issues associated with reporting have been already worked out in the context of the Javits report, and this model can be extended to notifications. For license notifications, State should replace informal pre-consultations with a monthly written report to Congress and the Senate and House Foreign Relations Committees that would broadly describe applications it had received that would require notification if approved. The later approval of the license would then trigger the 50-day process of consultation and written notification. This new process would ensure the same level of transparency for Congress but provide greater certainty to agencies and industry.

Currently, State knows within a day or two of receiving an application whether notification will be required. The practice has been to wait until approval of a license to begin the consultation processes, but since most licenses are approved this wait is unnecessary. Once State had reported a proposed license to the relevant Committees, it could then begin the formal 15 or 30 day notification once the license was approved unless the Committees indicate a sale is controversial. Appropriate safeguards, similar to those used in other reporting, would be needed

to protect proprietary information. Some might argue that this reporting intrudes executive branch prerogatives, but it is actually less intrusive than the informal practices that have grown up over the last few years.

A transparent, predictable mechanism based on reporting and formal consultation would end the uncertainty associated with the current process. Advance reporting to Congress on potential notifications would also avoid the problem of having notifications submitted during recess - Congress has legitimate concerns that the thirty day clock would be triggered when it was not in session, but providing a monthly report in advance of the notification process would address these concerns. This would also allow members of Congress, if they opposed a proposed sale, the time they need to consult with the administration or draft and introduce a joint resolution of disapproval (the legislative vehicle provided by the AECA to stop an arms sale). Allowing sufficient time for the early expression of concern by a member would provide an opportunity for the Administration to weigh the political and security issue and to address concerns well in advance.

Bridging the Government Divide

The challenge of government in the 21st century is to find efficient mechanisms to bridge the divisions in government that we have inherited from the past. The overwhelming frustration of the current system, however, is its hopeless inefficiency and maddening unpredictability. The challenge we face is to create a government oversight and regulatory mechanism that preserves varying policy perspectives while overcoming the inefficiencies of bureaucratic politics. For arms exports, and for export controls in general, three models are possible.

- ❑ Retain the current three-headed administrative structure, but draft new regulatory procedures to attempt to overcome the worst features of institutional intransigence and protectionism.
- ❑ Create a new agency to perform the administrative functions for licensing now performed at State, Commerce, Defense and Treasury, while ensuring that each agency retains its review and approval rights.
- ❑ Consolidate the administrative functions into a single existing agency while preserving policy oversight by agencies.

Retaining the current bureaucratic structure, while arguably the easiest approach, will not fix what is broken and will continue to erode our national security. On balance, the Commission believes that the best approach for interagency streamlining is to consolidate the administrative functions—but not the policy responsibilities--into a single agency.

Developing an appropriate organization structure for arms exports was one the most difficult issues the Commission examined. The idea that the best reform would be to consolidate export

control functions into a single agency is not new - the Senate Committee on Governmental Affairs held hearings in 1981 on establishing an independent agency. The concern with an independent agency is that it would lack the authority that is conferred by being part of a cabinet Department and being able to escalate matters to a Cabinet Secretary. The FCC and USTR have been able to avoid this problem - USTR is part of the White House and the Trade Representative is a Cabinet Rank official - but the head of a new export control agency does not require cabinet rank. If a new agency were created, it would need strong legislative authorities and might need to be attached to the White House in some fashion.

Consolidation of all export control functions at an existing agency would be an attractive option, if there is some way to detach the existing export control agencies from the substantial baggage they carry. If the U.S. chooses to centralize the administrative aspects of the license application process, each of the cabinet departments would retain the authority to review and approve or disapprove license applications. Policy prerogatives would not change. In particular, for the Secretary of State, there would be considerable benefit. The Department would no longer be responsible for a difficult administrative function that it has had trouble with for more than a decade. The policy prerogatives of the Secretary would be, however, entirely preserved. The role of State (and other agencies) would be focused on the policy issues and not process.

The various reforms we have suggested -- creating a waiver for allies, developing process and package licensing, streamlining the munitions list, improving the Congressional notification process -- can be implemented independently of each other and without waiting for organizational changes. We believe that there would be considerable benefit from a new organization structure, and from implementing these reforms as a package, but each proposal, even if implemented independent of the others, would improve national security. Our view is that the Administration should immediately implement those changes to the military export process -- extension of the ITAR waiver, creation of package and process licenses, streamlining of the USML and bringing greater discipline to the Congressional Notification process. These could be completed within the next twelve months. It should at the same time begin a process to consider the options for administrative reform of export licensing, allowing itself a longer period for review and taking the necessary steps to involve Congress and other parties in the process. Combining the administrative functions of the export control system into a single point for the entire government would be a strategic step in the right direction.

Conclusion

Building an export control system that will serve national security in the 21st century will not be an easy task, given the accretion of rules and bureaucratic prerogatives that currently surrounds the process. The consequences, however, of failing to reform, will be costly. Antiquated export controls will lead U.S. and European industry to drift further apart, putting pressure on NATO. More isolated national industrial bases mean, as technological change continues to accelerate, less competition and less innovation. This would ensure less interoperability and, potentially, a situation where our military no longer has the advanced technologies and weapons it needs to

Partnership Within the Federal Government

stay ahead of any potential adversary.

Effective reform will require both legislative and regulatory changes. While the task may be daunting, failure to take up the challenge will only damage the national security of the United States. Our task is to make the changes and build the partnerships we need to make military export controls continue to serve our national security interests.