

COALITION FOR SECURITY AND COMPETITIVENESS

RECOMMENDATIONS FOR MODERNIZING EXPORT CONTROLS ON DUAL-USE ITEMS

EXECUTIVE SUMMARY

March 6, 2007

The United States currently faces unprecedented threats to its security both at home and abroad. In confronting these threats, we must be able to exploit the full advantage we derive from our economic strength and technological prowess. To that end, the U.S. export control system must be modernized so that it is better able to respond quickly and effectively to evolving security threats, and promote our nation's continued economic and technological leadership. The Coalition for Security and Competitiveness, representing multiple industry and trade associations, is committed to working with the Executive Branch and Congress in a cooperative spirit to accomplish these important goals.

To modernize the system and make it more efficient, predictable and transparent, the Coalition has developed the following eight recommendations on export controls for dual-use items:

- Create a license exception for the transfer of controlled items within companies
- Certify foreign end-users with strong compliance programs for favorable treatment
- Enhance procedural transparency in the licensing process to help companies comply
- Enhance the Commerce Department's role in the "commodity jurisdiction" process for determining whether or not dual-use products should be treated as defense products and subject to State Department licensing
- Streamline the current complex controls on products with encryption features
- Ensure timely updates of the Commerce Control List (CCL) to reflect market availability
- Expand factors used to determine "foreign availability" of controlled items
- Revise the "re-export" controls to level the playing field for U.S. companies vis-à-vis foreign competitors.

A more detailed description of the Coalition's concerns and proposals for action is provided in the attached recommendations. Additional recommendations for modernizing export controls on Munitions List items, as well as other information on the Coalition, can be found on www.securityandcompetitiveness.org.

RECOMMENDATIONS FOR MODERNIZING EXPORT CONTROLS ON DUAL-USE ITEMS

PROPOSAL: Create a license exception for intra-company transfers

U.S. companies exporting dual-use goods or technology to their foreign affiliates are still subject to U.S. export controls and may be required to obtain individual export licenses. Licensing requirements can also apply to “deemed exports” to company employees in the United States (i.e., the release of controlled technology to a foreign national within the U.S.). The regulations do not take into account the fact that many U.S. companies have company-wide policies on export compliance that apply to their foreign facilities and employees and serve to protect national security. U.S. companies have their own incentives to maintain strong controls to protect their intellectual property. The internal company policies produce two tangible, complementary benefits: 1) increased security controlling the release of proprietary technology and information; and 2) increased compliance with U.S. export control regulations.

Even though license applications are still required, there is a high rate of export license approvals for transfers of products and technology to foreign affiliates and for “deemed exports” in the United States—an implicit acknowledgement that U.S. companies maintain effective controls over foreign nationals’ access to sensitive goods and technology. However, the long delays and additional costs associated with obtaining export authorizations for intra-company transfers put U.S. companies at a competitive disadvantage vis-à-vis their foreign competitors. High-technology companies, many of which make important contributions to U.S. defense and industrial leadership, have identified this issue as one of the most important for improving dual-use export controls.

The Bureau of Industry and Security (BIS) has previously recognized that intra-company transfers should receive special treatment in the development of encryption products. Moreover, the proposed Validated End-User program for China and India suggests that such a program could be implemented. A new intra-company export authorization would not only improve the international competitiveness of U.S. companies, but it would also allow BIS to concentrate more resources on exports that may pose greater risks to U.S. national security.

Recommended Modernization

To stay competitive in today’s marketplace and ensure a healthy industrial base for national security purposes, globally integrated companies should have the ability to transfer goods, technology and skilled personnel between their U.S. and overseas facilities in a timely manner. We therefore recommend the following:

- Commerce should create a license exception for intra-company transfers, including “deemed exports”, for companies that have strong compliance programs. This approach would streamline the export authorization process, reduce the licensing burden on U.S. exporters and enhance international competitiveness without compromising U.S. national security concerns. The license exception would not

apply to dual-use items that require licenses by current legislation.

- To ensure that the new program is effective in meeting security and business needs, the scope and procedures should be developed through an open government and industry consultative process. Key areas to be addressed include: company-wide compliance standards; benefits of participation; scope of permissible transfers; reporting; and enforcement mechanisms.

PROPOSAL: Certify foreign end-users with strong compliance programs

At present, the Export Administration Regulations (EAR) do not provide expedited treatment for foreign end-users with strong track records of compliance. The current process could be made more efficient for both the Commerce Department and U.S. exporters if export authorization procedures distinguished among foreign end-users. Foreign end-users who meet certain criteria established by BIS (i.e., Validated End-Users/VEU) could receive more favorable treatment, including the possibility of obtaining controlled products and technology through more efficient means. A certification program would allow more time and resources to be devoted to monitoring and reviewing high-risk and complex transactions. It would also encourage foreign end-users to strengthen their compliance programs. A VEU program has already been proposed for China and India. This concept should be expanded to allow validation globally of end-users that meet the specified criteria.

Recommended Modernization

Commerce should implement a VEU program to expedite authorizations for reputable foreign companies with a proven record of compliance. The VEU program should be improved by including the following elements:

- Eligibility for validated end-users to receive products/technology (including “deemed exports”) associated with any eligible Export Control Classification Number (ECCN)
- Clear, achievable criteria for validating an end-user
- Specified timeframes for reviewing and approving VEU applications
- Guarantee that the denial of an end-user’s VEU application would not be held against the end-user during reviews of future license applications
- Clear requirements for compliance programs for validated end-users

PROPOSAL: Enhance procedural transparency in the licensing process

Improving the availability of information to U.S. exporters would promote greater efficiency in both the pre-licensing stage and licensing process. Limits on procedural transparency are a particular problem, notably with regard to prohibited end-users and intermediaries. Although the Bureau of Industry and Security (BIS) website provides

detailed information on some aspects of the export licensing process, issues relating to commodity classification, technology transfers and general licensing need to be more fully addressed. Some of these questions might be answered through greater availability of BIS advisory opinions on specific cases. Improving information on “denied parties” would also help U.S. exporters to comply with requirements and reduce unnecessary compliance costs and uncertainty.

Recommended Modernization

To enhance procedural transparency and provide greater information on end-users, the Commerce Department should:

- Publicize advisory opinions (with the consent of the companies involved)
- Provide on the BIS website more detailed answers to frequently asked questions (FAQs) on commodity classification, technology transfers and general licensing issues relevant to current export licensing cases
- Assist companies in identifying “denied parties” by:
 - Publishing, in appropriate cases, the results of adverse licensing decisions and identifying the parties of concern
 - Publishing a denied party’s name in both the native language and English
 - Ensuring accurate and up-to-date information on “denied parties”
 - Improving website search engines used to identify “denied parties”
 - Consolidating this information, to the maximum extent possible, in a single location and allowing accessibility to promote due-diligence

PROPOSAL: Enhance the Commerce Department’s role in the commodity jurisdiction process

Commodity jurisdiction (CJ) determinations, which are under the purview of the State Department, affect many dual-use exports. Export requirements and restrictions become more stringent when a dual-use item is re-classified by the State Department as a defense article subject to the International Traffic in Arms Regulations (ITAR). The presence of ITAR-controlled items in a larger commercial system subjects the entire system to stringent U.S. Munitions List (USML) controls. Dual-use use items may be re-classified as ITAR-controlled items even if they are the performance equivalent of commercial items and do not have significant military or intelligence applicability.

Although the President delegates CJ authority to the State Department, the potential impact on dual-use items makes it critically important for the Commerce Department to be fully engaged in the inter-agency process for making these determinations. The Commerce Department can and should provide important information on the commercial applications of dual-use technology, which can predominate. The Department can also help clarify whether other countries are controlling the same technology and how their application of controls might differ from that of the United States. According to existing regulations, these factors are relevant in the CJ process. It is appropriate, then, for the Commerce Department to have an enhanced role in the CJ process and U.S. efforts to

strengthen harmonization of controls with our international regime partners.

Recommended Modernization

- Affirm the Commerce Department’s role in the Commodity Jurisdiction process by:
 - Designating the Commerce Department as the lead agency for analyzing “predominant civil applications” and “commercial equivalency” of an item
 - Establishing a process by which the Commerce Department can work with industry to develop the factual record regarding the predominance of civil applications and foreign availability of the dual-use item
- Support restoration of the practice of publishing CJ determinations (with appropriate sensitivity to protection of proprietary information) for use by industry as guidance
- Seek to ensure that the Commerce Department and Defense Department have full transparency into the State Department CJ process
- Work with participants in the Wassenaar Arrangement and other international regimes to harmonize approaches to classification and control of dual-use items
- Establish an interagency appeals process for decisions on critical jurisdiction and licensing applications
- Support the recommendations on the CJ determination process contained in the Coalition’s proposals for defense trade modernization

PROPOSAL: Streamline encryption export controls

Encryption technology controls create compliance burdens for exporters. The encryption regulations are overly complicated and difficult for U.S. exporters to understand and comply with them. Excessive reporting requirements and lack of transparency in the process add to the compliance burdens.

Under BIS procedures, there is a cumbersome requirement to register before export every new software product that performs data encryption. Most software products rely on a limited number of encryption packages. Yet exporters have to repeat the registration process with the Bureau of Industry and Security (BIS) and the National Security Agency for almost every new product even if the encryption package was previously approved by the government.

While incremental rule changes have occurred in recent years for the treatment of encryption products, the fundamental registration process continues to require detailed submissions for mainstream commercial products which use similar encryption packages that the government has previously reviewed. Requirements still apply to open source encryption that is publicly available on the Internet. This availability makes it difficult to justify the need for requesting such detailed information to register a product. From the perspective of U.S. exporters, the registration requirement is an inefficient use of both

Industry and government resources.

Recommended Modernization

Encryption rules should be simplified to help industry comply with the regulations and reduce administrative costs. Specifically BIS should:

- Conduct a fundamental review of policy in this area to determine whether the control systems in place are aligned with policy goals. Specifically, the review should address whether commercial and open source (i.e., publicly available) encryption still needs to be controlled in the current manner
- Streamline encryption reviews, crypto-aware notifications and license applications requirements so that industry can reference previously reported information without re-applying for approval. This would allow the government to focus limited resources on encryption items of higher-level concern
- Streamline encryption exceptions to reduce the burden of complying with the different provisions on market availability. For example, we recommend the elimination of reporting of License Exception ENC unrestricted software, which is currently required, and harmonization on treatment of software that is widely available
- Review all encryption regulations to make them more clear and concise so that the actual regulation itself is not overly burdensome

PROPOSAL: Update the Commerce Control List (CCL)

The CCL covers a broad range of products and technologies, many of which are no longer sensitive. While minor changes have been made to conform the CCL with revisions in the international regime control lists, the Commerce Department has not conducted a comprehensive review of the entire CCL for over ten years. Rapid advances in technology and the growing sophistication of industry in both developed and emerging economies have now rendered controls on many items obsolete.

In the absence of compelling foreign policy concerns, maintaining controls on items that are available in the global marketplace provides little benefit to U.S. national security and diverts resources needed to ensure export compliance on sensitive items. Such a practice also puts U.S. exporters at a competitive disadvantage vis-à-vis foreign counterparts who can export items without the same restrictions. This results in the loss of potential business opportunities and also contributes to the “design out” of U.S. items in products made by foreign companies. Greater harmonization of export controls and their implementation will enable U.S.-based companies to compete on a more equal footing with foreign companies (notably European and Japanese) in an increasingly competitive global marketplace.

Recommended Modernization

BIS should establish a systematic process for reviewing the entire CCL on a timelier basis and:

- Reinvigorate the process for determining whether items are available from foreign sources by establishing clear deadlines and criteria for decisions to adjust or remove controls on such items on the CCL
- Expand the role for non-government advisers (e.g., the Technical Advisory Committees) to assess changes in controlled technologies and their availability in the global marketplace
- Update CCL product descriptions to reflect the intent of the multilateral controls and to eliminate overly broad “accident of definition” coverage that captures non-critical items that are not controlled by other countries
- Use the new Office of Technology Evaluation to improve CCL reviews and foreign availability assessments
- Initiate a thorough and periodic review of the effectiveness of unilateral controls
- Better coordinate and harmonize high-level technology controls on products and technologies covered by the multilateral regimes, particularly with respect to differences between the United States and European Union members

PROPOSAL: Expand factors used to determine “foreign availability”

The current process for determining “foreign availability” puts U.S.-made products at a competitive disadvantage vis-à-vis foreign-made products. In making determinations, the Commerce Department does not consider availability from countries that participate in the multilateral regimes. This approach to “foreign availability” assumes that all dual-use items controlled by the United States are also controlled by our regime partners in the same way. This is not the case. Even though the CCL and international lists are now very similar, many items restricted by the United States are available in Wassenaar member countries because of differences, for example, in licensing administration, compliance and enforcement procedures, technical interpretation of the lists and application of re-export rules.

Under the previous CoCom regime (Coordinating Committee for Multilateral Export Controls) that governed dual-use exports during the Cold War, the United States could veto licenses and prevent its regime partners from exporting dual-use items when there were disagreements on what should be controlled. This is not possible in the current multilateral regimes. As a result, items subject to U.S. controls are now more readily available in other countries, including members of the international regimes. This reality needs to be acknowledged in the current “foreign availability” process.

Recommended Modernization

To make most effective use of limited resources in controlling sensitive items, the Commerce Department should:

- Recognize foreign availability of items from member countries of the international export control regimes
- Stop controlling items where there is foreign availability or indigenous production in countries of concern unless there are reasons to impose foreign policy controls (e.g., related to anti-terrorism, non-proliferation or missile technology control)

PROPOSAL: Revise re-export controls to level the playing field for U.S. companies

The United States is only one of a handful of countries that impose re-export controls. The U.S. government requires that foreign purchasers of U.S.-controlled items apply for an export license if they intend to re-export the product to a third country, incorporate the U.S. item into a product to be exported to a third foreign party, or produce a product from U.S. technology for export to another destination.

These re-export controls impose a significant compliance burden on U.S. companies and their foreign business partners. U.S. companies are finding that the complexity of the re-export restrictions discourage foreign companies from purchasing U.S.-made products. A broader concern is that the restrictions are causing foreign companies to “design out” U.S. components in favor of components from countries without stringent re-export controls. Increasing foreign availability of many controlled items is exacerbating the concern over “design out” and putting U.S. companies at an even greater competitive disadvantage.

Recommended Modernization

The Commerce Department should adopt a more realistic approach to regulating the re-export of controlled items that recognizes the complexity of global supply and distribution chains and the difficulty of enforcing licensing requirements on foreign companies. The Department would make more effective use of its limited resources and ease the burden on U.S. companies if it simplified the requirements and relied more heavily on enforcement by foreign countries that participate in the multilateral export control regimes. We recommend that the Commerce Department engage industry on developing alternative approaches to the current re-export controls. Our initial recommendations are for the Department to:

- Create a license exception for the re-export of items that are available from other foreign sources, assuming there are no reasons for imposing foreign policy controls
- Create a new license exception or expand the license exceptions for re-exports from foreign countries that maintain high export control standards or participate in the multilateral export control regimes