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EXPORT LICENSING

Commerce-Defense Review of Applications to Certain Free World Nations

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The Honorable Jake Garn, Chairman
Committee on Banking, Housing and
Urban Affairs
United States Senate

The Honorable Dante B. Fascell, Chairman
Committee on Foreign Affairs
House of Representatives

As part of our efforts to provide your Committees with information on export administration, this report discusses export licensing at the Departments of Commerce and Defense under the terms of a January 1985 Presidential directive. In response to the expanded role of the Defense Department in export administration, this report describes the bases of Defense's licensing recommendations to the Commerce Department and Commerce's subsequent licensing decisions.

Copies of this report are being sent to the Secretaries of Commerce and Defense and to other interested parties.

Frank C Conahan

Frank C. Conahan
Assistant Comptroller General

Executive Summary

Purpose

Soviet bloc countries acquire militarily significant commercial (i.e., "dual-use") products from other countries. The U.S. government attempts to limit or prevent such access through an export licensing system. The Commerce Department issues export licenses under the authority of the Export Administration Act of 1979, as amended. The Department of Defense also has authority to review some export license applications, but there has been no consensus on the nature and extent of its role. A January 1985 Presidential directive clarified Defense's role by giving it added responsibilities to review applications to selected free world destinations and to make licensing recommendations to the Commerce Department.

GAO reviewed export licensing under the terms of the Presidential directive to determine the nature and extent of differences resulting from this joint review. To this end, GAO reviewed how the (1) Defense Department developed its recommendations and (2) Commerce Department responded to these recommendations with licensing decisions.

Background

The Defense Department is now responsible for evaluating all license applications involving exports in 8 product categories to 15 free world countries.

Commerce and Defense generally use similar procedures to evaluate license applications. Both evaluate the diversion potential of end users based on information provided by such sources as diplomatic posts overseas, the U.S. Customs Service, and the intelligence community.

At the Defense Department, information referred from Commerce is compared electronically with (1) a list of individuals and firms that are considered potential diverters, (2) countries with questionable export control procedures, (3) characteristics which define a product's sophistication, and (4) questionable addresses of the end users, such as a post office box.

Results in Brief

GAO observations and conclusions are based on its evaluation of all license applications (671) referred to the Defense Department during April 1 through 12, 1985. GAO compiled detailed licensing histories of all applications that Defense wanted to deny during this period (60),and its report focuses on these applications.

For the period GAO examined, Commerce approved about 65 percent of the license applications that Defense wanted to deny and denied about 1 percent of the licenses that Defense wanted to approve.

Defense generally based its denial recommendations on general categories of concern rather than on specific adverse information related to individual license applications. Commerce makes licensing decisions principally based on the latter kind of information.

Defense did not share with Commerce all the information it used to support its recommendations. Defense, however, began supporting its recommendations with more specific information later in 1985.

The major policy issue dividing Commerce and Defense during the period of the GAO review was the appropriateness of issuing export licenses when the foreign purchasers planned to resell the items to customers unknown to U.S. licensing authorities. During 1985 and 1986 Commerce and Defense took steps to resolve their differences.

Commerce and Defense steps to better coordinate efforts through improved sharing of information and resolving policy differences should lead to greater consistency between Defense recommendations and Commerce licensing actions. A high level of consistency in future reviews will raise the question of whether Defense review of individual free world license applications should be continued in its present form.

Principal Findings

Defense Licensing Recommendations

Defense recommended approval for 91 percent of the applications it reviewed and recommended denial for 9 percent (60 applications). Defense based 24 of its 60 denial recommendations on concerns about the end users. In 67 percent of these 24 cases, the basis of its concerns was information provided by Dun & Bradstreet. Defense interpreted Dun & Bradstreet's information as adverse because (1) Hong Kong end users did much of their business in the People's Republic of China, (2) some end users did not appear to be in business, (3) the end users' businesses were inconsistent with end use statements in the applications, and (4) there was insufficient information about the end users. Defense based another 31 of its 60 denials on concerns about end use. Specifically, Defense officials did not believe that controlled products should be

licensed to foreign distributors for resale to persons unknown to U.S. licensing authorities. The resale issue figured in 87 percent of these 31 denials. Control over resale was a particularly contentious issue between Commerce and Defense in 1985 and 1986.

Commerce Licensing Decisions

Commerce granted licenses to 79 percent (482 applications) of the applications for which Defense recommended approval and denied licenses to about 1 percent. (19 percent of the applications for which Defense recommended approval were returned to the applicants without action by Commerce and 5 applications were pending as of December 31, 1985.)

Commerce did not concur in 65 percent (39 applications) of Defense's denial recommendations.

Commerce officials generally approved applications based on their usual review procedures. For those applications that Defense officials wanted to deny, Commerce concurred only when Defense provided sufficient specific information to justify a negative determination.

Agency Comments and GAO's Evaluation

Commerce agreed with GAO's findings but noted that the evidence in the report appears to call into question the justification of Defense's West-West review. Defense stated that while it does not argue with the GAO's analysis of the license applications, the analysis may not be representative because the period covered was quite early in the start-up of the program. Defense also stated that it does not agree with GAO's conclusion. Defense stated that the issue is not consistency between Defense and Commerce licensing decisions but rather the quality and effectiveness of the reviews.

The license applications GAO examined were reviewed by Defense during the start-up phase of its operation. However, GAO found that the extent of Defense requests to Commerce for detailed information and the extent of its subsequent recommendations on license applications referred during the first 2 weeks of May, June, and July 1985 were similar to those in April 1985. GAO also found the bases of Defense's denial recommendations for November 18-22, 1985, were essentially the same as those for the applications GAO reviewed in April.

Consistency in licensing actions is not a consideration that can or should be viewed as incompatible with quality and effectiveness. When common policies are effectively administered by both Commerce and

Defense in reviewing the same export applications under the same criteria for essentially the same goals, the results should be a high level of consistency between Defense's recommendations and Commerce's licensing decisions. If such a high level of consistency is achieved, it will be reasonable to question such a duplicative process and, since Commerce has the broader export licensing responsibilities, the question will likely focus on whether or not to continue Defense's role in its present form.

Contents

Abbreviations

COCOM	Coordinating Committee
DTSA	Defense Technology Security Administration
GAO	General Accounting Office
OEA	Office of Export Administration
OEE	Office of Export Enforcement

Introduction

The U.S. government has controlled the export of militarily significant commercial (i.e., "dual-use") products to the Soviet bloc since 1949 by licensing the export of controlled products to almost all destinations. Under the Export Administration Act of 1979, as amended,[1] the Secretary of Commerce administers the control system and issues export licenses. However, section 10(g) of the Act also includes "special procedures" for the Secretary of Defense to review some kinds of export license applications. Defining the exact scope and nature of Defense's review responsibilities has been a matter of continuing conflict between the Departments of Commerce and Defense. Until recently, Defense's major role in export licensing involved the review of license applications to export products to the Soviet bloc and the People's Republic of China. In January 1985, the President issued a directive to resolve this conflict. The directive expanded Defense's review to include applications related to specific product categories for 15 so-called free world destinations (see p. 10).

The Export Control System

Export controls are intended to complicate the Soviet's efforts to obtain dual-use products and technology by forcing them to use uncertain means to acquire products that they cannot legally obtain. To achieve this goal, the United States controls the export of dual-use items for national security purposes under provisions established by the Export Administration Act.[2] The export control system's three principal functions are to (1) identify technologies and products that need to be controlled, (2) review and evaluate export license applications, and (3) enforce export controls. Although the U.S. government unilaterally controls some commercial products and technologies for national security reasons, most such products are controlled by the coordinated action of the United States and 15 other governments comprising an informal organization known as the Coordinating Committee, or more simply COCOM.[3]

The U.S. government controls exports of dual-use products with a licensing system. A U.S. exporter wishing to sell controlled products

[1]The Export Administration Act was substantially amended in 1985 by Public Law 99-64. The authority granted by the Act terminates on September 30, 1989. The Conference Committee Report on the amendments (p. 62) said that "one of the most contentious issues [during congressional deliberations] was that of defining the role of the Department of Defense in the licensing process," and as a consequence, the section of the Act dealing with Defense's role was not amended in 1985.

[2]The government also restricts the export of goods and technology in order to (1) further U.S. foreign policy and (2) protect the domestic economy from the excessive drain of scarce materials.

[3]COCOM consists of NATO member governments (except Iceland) plus Japan.

anywhere in the world, except Canada, must seek the government's permission through an export license application. One kind of license, the "individual validated license," as a general rule authorizes shipments of specifically named controlled items to a specified end user for a specified end use. Another kind of license, the "distribution license," authorizes multiple shipments of a broad range of controlled products to overseas distributors who, in turn, resell such items to their customers, the actual end users. In 1985, the government approved 102,347 and denied 813 export licenses.

The Role of the Defense Department Under the Export Administration Act

Section 10(g) of the Act states that the Secretary of Defense is

> "authorized to review any proposed export of any goods or technology to any country to which exports are controlled for national security purposes and, whenever the Secretary of Defense determines that the export of such goods or technology will make a significant contribution, which would prove detrimental to the national security of the United States, to the military potential of any such country, to recommend to the President that such export be disapproved."

However, the Act did not specifically define countries "to which exports are controlled for national security purposes," and this omission led to interpretative differences between Commerce and Defense. In mid-1981, the Defense Department asserted that it had responsibility under the Act to review export license applications to free world destinations, including responsibility to (1) generally monitor the potential for diversion from such countries and (2) specifically evaluate the diversion potential of an end user and assess the validity of an applicant's end-use statement.

The Commerce Department, on the other hand, interpreted Defense's perception of its responsibility differently. At that time, Commerce asserted that Defense had the authority to review license applications to Soviet bloc destinations only, and therefore it was not appropriate for Defense to assess the diversion potential of end users in free world countries as part of the licensing process.

Prior to the January 1985 Presidential directive, these differences were temporarily resolved by a September 1981 interagency understanding whereby Defense reviewed high-technology, computer-related license applications to most free world destinations. Whether or not Commerce referred such applications to Defense depended on specific operating characteristics of the item proposed for export and on whether the end user was in a special category, such as a government agency.

Applications also are routinely reviewed by the Departments of State and Energy.

The Presidential Directive

A 1985 Presidential directive expanded the scope of the 1981 understanding. Added to Defense's review of proposed exports to the Soviet bloc and China were all applications for 8 product categories exported to 15 free world destinations.[4] The specific countries and product groups, but not the number of destinations and product groups, can be altered only by agreement between Commerce and Defense. However, at the time of our review no COCOM destinations were subject to Defense review. The directive also authorized the establishment of a Technology Transfer Steering Group, composed of officials from Commerce, Defense, and the National Security Council, to resolve disputes between Commerce and Defense over licensing recommendations related to the directive. Unresolved disputes can be appealed to the President.

Through December 31, 1985, the Steering Group held one meeting. The limited use of this dispute resolution mechanism, however, understates the differences that exist between Commerce and Defense. The directive stated that Defense's objections to issuing an export license must be made "with specificity." Commerce and Defense officials have differed over what this phrase means, with the result that Commerce has approved some applications which Defense recommended be denied because, according to Commerce officials, their requests for more specificity were not met by Defense. Commerce made licensing decisions in such cases using its normal processing criteria. Neither Commerce nor Defense referred such applications to the Steering Group for review.

Objectives, Scope, and Methodology

We made this review to determine the nature and extent of differences that have resulted from joint Commerce and Defense reviews of free world license applications. To this end, we reviewed how the (1) Department of Defense developed its recommendations for the export license applications it reviewed under the terms of the Presidential directive and (2) Department of Commerce responded to these recommendations.

[4]At the time of our review the countries were Austria, Finland, Hong Kong, India, Iran, Iraq, Lichtenstein, Libya, Malaysia, South Africa, Singapore, Spain, Sweden, Syria, and Switzerland. The product groups included computers; software; electronics and semiconductor manufacturing, measuring, and calibrating equipment; micro and integrated circuits; and carbon technology and manufacturing equipment.

To understand this process, we reviewed all (694) license applications sent to Defense from Commerce during April 1 to 12, 1985. To determine whether our test period was representative of the issues that have been occurring between Commerce and Defense, we reviewed all applications referred to Defense during the first 2 weeks of May, June, and July 1985.

Our detailed analysis focused on the 60 applications which Defense recommended be denied during the April period. To determine the bases of Defense recommendations and Commerce licensing decisions, we collected documents pertaining to these recommendations and decisions and discussed many of them with licensing officials at Commerce and Defense.

We did not assess the administrative efficiency of the export licensing process. For example, we did not evaluate whether one agency makes better use of electronic data processing techniques than another or whether any specific aspects of either agency's license review procedures appeared to be a better way to make determinations.

Our review was performed in accordance with generally accepted government auditing standards.

Export Administration at the Departments of Commerce and Defense

Reviewing export license applications basically consists of three kinds of technical, or non-policy-oriented, evaluations. Evaluators must determine (1) a specific commercial product's potential military significance,[1] (2) the diversion potential of the end user, and (3) the appropriateness of the product's stated end use on a license application. Applications also are reviewed within the context of foreign and national security policies. Consequently, a proposed export to a legitimate end user for a purely commercial end use can be denied for policy purposes, as was the case with some of the applications we reviewed.

For proposed exports to proscribed destinations (mainly the Soviet bloc and China), the potential military significance of a product is the most relevant evaluation the government makes. Relatively less importance is given to end-use and end-user evaluations. The prudent assumption in such cases is that in proscribed countries the military has unrestricted access to imported products, regardless of whether the stated end user is a civilian and the stated end use is commercial.

For proposed exports to free world destinations, evaluators focus on the potential for diversion to the Soviet bloc by an end user,[2] looking at information about a firm or individual to determine the risk of diversion. An end use evaluation in such cases is an indirect assessment of an end user, because it can involve a comparison between the stated end use and the technical capabilities of the proposed export. For example, if an item is more sophisticated than someone reasonably needs (i.e., the proposed sale of a large computer to a small shopkeeper), there might be reason to suspect the intentions of a seemingly legitimate end user. When the information raises sufficient doubt, Commerce licensing officials will either condition approval, return the application without action usually because it is incomplete in some way, or deny the license application.

[1]Commerce's commodity control list is a listing of product categories, not specific commercial products. Such products are "captured" by a category, and thus considered militarily significant, if they meet certain performance characteristics.

[2]Countries covered by the directive, such as Libya, Syria, Iran, and Iraq, are exceptions to this generalization. Exports to them are covered by specific export administration regulations. The military significance of proposed exports to such countries presumably is relevant quite aside from concerns about the potential for diversion from them to the Soviet bloc.

Commerce and Defense License Application Review Process

Both Defense and Commerce have procedures and personnel for making the three kinds of technical evaluations. Commerce has been primarily responsible for determining the diversion potential of end users and the appropriateness of the end use stated on applications. Commerce traditionally has relied on Defense to assess a product's military significance for some proposed exports to the Soviet bloc and other proscribed destinations, because Defense is considered to have more information and resources with which to evaluate the potential military significance of a commercial product.[3]

Implementation of Presidential Directive

To fulfill its new responsibilities under the terms of the directive, Defense has taken steps to enable it to evaluate the diversion potential of an end user, the type of ongoing analysis regularly performed by Commerce. These steps have included purchasing business information on foreign firms, collecting relevant data from other U.S. agencies, developing a list of suspicious end users, and setting up a computerized system to screen licenses.

Defense has purchased the services of Dun & Bradstreet, a commercial firm which collects and sells economic, financial, and historical information about businesses all over the world. Commerce also buys this kind of information from Dun & Bradstreet, but on a more limited basis. Defense, just as Commerce has done, also collects end-user related information from other government agencies.

Both Commerce's Office of Export Enforcement (OEE) and the Defense Technology Security Administration (DTSA) have developed lists of suspicious end users. OEE, for example, has a list of about 5,000 names for which it has some enforcement concern. The names come from investigations, anonymous sources, the Customs Service, and newspapers. The intelligence community has also provided classified information from which a list of about 900 additional suspicious end users was compiled. DTSA's list is compiled from information in cables from U.S. embassies and offices overseas, the Defense Intelligence Agency, and other U.S. intelligence agencies. DTSA analyzes information from these sources to determine whether it is relevant from the point of view of export controls. The results of DTSA's analyses are not shared with Commerce except indirectly as support for a recommendation on a specific license

[3]The Export Administration Amendments of 1985 authorized establishment of a National Security Control Office at the Department of Defense, and the Defense Technology Security Administration was formed on May 10, 1985.

application. Similarly, Commerce does not share the information it develops with DTSA.

In response to the directive, Defense has established a procedure to automatically screen the applications it receives from Commerce. Information from all applications covered by the directive's criteria is electronically transmitted from Commerce to Defense. Defense screens it against (1) its list of suspicious or known bad end users, (2) a list of countries that have inadequate export control procedures, (3) a combination of variables which define a product's sophistication and/or value, and (4) a list of addresses to determine whether the end user's address is a post office box. These screens help Defense to identify quickly those applications which should be reviewed in detail for policy and technical reasons. Defense has 7 calendar days to review applications referred from Commerce; if it determines that certain applications need further review, it has 15 additional working days to review them and any associated documents and make recommendations to Commerce. The time it takes Commerce to assemble the necessary documents and send them to Defense is not counted against this 15-day review period.

As of July 1985, Defense began comparing the end users on all applications it receives against a Dun & Bradstreet library of reports on about 20,000 firms in the countries covered by the directive. If an end user is one of these firms, a report is produced at Defense from Dun & Bradstreet's data base. Previously, Defense officials would decide whether they wanted to request Dun & Bradstreet reports on an application-by-application basis. Commerce does not have a comparable system for routinely accessing Dun & Bradstreet reports.

OEE electronically screens all applications against its lists of potential and known bad end users concurrently with Defense's review and forwards its recommendations to Commerce's licensing office. Commerce's licensing office does not begin policy and technical reviews of applications covered by the directive until it receives Defense's recommendations.[4]

At the time of our test period, Defense was not routinely informed of Commerce's licensing actions on the applications reviewed by Defense. But in January 1986, Commerce began routinely notifying Defense of its

[4]Commerce initially reviews applications for completeness, and returns incomplete applications to applicants without action regardless of Defense's review and recommendations. Such an administrative review is made concurrently with Defense's review. Commerce reorganized export administration during the period of our review.

proposed licensing decisions when they were contrary to Defense's recommendations.

Licensing Decisions at Commerce and Defense

During April 1 through April 12, 1985, Defense reviewed 671 export license applications under the terms of the directive.[5] Defense's recommendations and Commerce's disposition of applications are shown in table 2.1.

Table 2.1: Disposition of Defense Recommendations to Approve or Deny License Applications

		Commerce Licensing Actions			
Defense recommendations	**Number of applications**	**Approved**	**Denied**	**Returned to applicant without action**	**Pending action**
1. Approval	611[a]	482	7	118	4
2. Denial	60	39	3	17	1
Total	**671**	**521**	**10**	**135[b]**	**5**

[a]Defense did not comment on 549 of these applications; for the other 62, it conditioned approval on meeting what it termed "standard free world conditions" or on the terms of various bilateral "memorandums of understandings" between the U.S. and foreign governments.

[b]Generally applications are returned to applicants without action because they are incomplete in some way. The returned without action rate on this table is 20 percent; in 1985 it was about 15 percent for all free world applications.

Applications for Which Defense Recommended Approval

Defense recommended approval for 611, or 91 percent, of the 671 applications it reviewed. Commerce actually approved 482, or 79 percent, of these 611 applications. Commerce denied 7 applications for which Defense had recommended approval, and 118 other applications were "returned without action." We reviewed the 7 denied applications and found that one involving a Libyan end user was denied for foreign policy reasons on the advice of the State Department. Another was denied on the basis of pre-existing intelligence agency reports which indicated that the end user was not a suitable recipient of U.S.-origin national security controlled commodities. The other 5 were denied on the basis of unfavorable pre-license checks of the end users by U.S. embassy officials overseas, as discussed below.

[5]Defense actually received information on 694 applications, but 3 of them were not covered by the directive's criteria and therefore were sent erroneously by Commerce. Commerce returned 20 other applications to the applicants without action after information from the applications was sent electronically to Defense but before Defense asked for copies of the applications. As a consequence, Defense did not receive copies of these applications.

1. An end user denied that it had purchased $6 million worth of personal computers and related equipment from the applicant. This pre-license check was initiated by a Commerce licensing officer because the country was considered a problem destination and because the end use involved the resale of a large number of items.[6]

2. An end user did not seem to have an active operation and may not have existed as a legitimate company.

3. An end user was not known to the business community, and the proposed end use apparently would have violated the importing country's import regulations.[6]

4. An end user apparently intended to sell the item to a customer in the People's Republic of China but would not reveal the customer's name to U.S. authorities.

5. An end user (distributor) would not provide a list of its customers to U.S. authorities.

Applications for Which Defense Recommended Denial

Defense recommended that Commerce deny 60 applications for the reasons shown in table 2.2. Commerce generally disagreed with Defense's denial recommendations and approved 39, or 65 percent, of the 60 applications. Commerce directly denied the applications for only 3 of the 60 applications. The rest were returned to the applicants without action, except for one application which was pending action as of December 31, 1985.

[6]Defense reviewed the entire application associated with this case.

Table 2.2: Disposition of Defense Recommendations to Deny License Applications[a]

		Commerce Licensing Actions			
Bases for Defense recommendations	**Number of applications**	**Approved**	**Denied**	**Returned to applicant without action**	**Pending action**
1. Suspicious end user (See p. 18)	24	15	1	7	1
2. End use concerns (See p. 22)	32	22	1	8	1
3. Foreign policy concerns[b]	5	2	2	1	0
4. Inadequate information[c]	10	8	0	2	0
5. Importing country lacks export controls[d]	2	0	0	2	0
6. Nuclear end use concerns[e]	1	0	0	1	0
Total	**74**	**47**	**4**	**21**	**2**
Actual number of applications	60	39	3	17	1

[a]Numbers on table refer to license applications but because Defense sometimes cited more than one reason for its recommendation, there is necessarily some double counting. The magnitude of double counting is reflected in the two sets of column total figures.

[b]Consists of three applications for exports to Libya, and one each for Syria and India. The Libyan applications were reviewed by the State Department, which recommended denial in two cases and approval in one. Export administration regulations stated that licenses for Libyan destinations will "generally be denied for - (i) Items controlled for national security purposes . . ." The application for India was returned to the applicant without action in order to clarify the end use.

[c]Denotes applications which, for example, lacked sufficient information on quantity or technical specifications of product or for which Commerce sent Defense wrong and confusing information about the end use. Defense also recommended denial for one of these applications because of its concerns about the end user.

[d]As a matter of policy, Defense recommended denial of some applications involving end users in Spain and Iraq. Spain is currently a member of COCOM, but at the time of our review, it was not a member.

[e]Application was also reviewed by the Department of Energy, based on Energy's review, Commerce asked the applicant for additional end-user and end-use information.

Evaluating the End User

Forty percent of Defense recommendations for denial of license applications were based at least in part on its assessment that the end users might illegally divert controlled products. We refer to this category of denial recommendations as based on the assessment that the foreign purchasers are "suspicious end users." As table 2.3 shows, Commerce approved 15, or 63 percent, of the 24 applications in this category that Defense recommended be denied.

Table 2.3: Disposition of Defense Recommendations to Deny License Applications Based on Suspicious End Users

		Commerce Licensing Actions			
Bases for recommendation	**Number of applications**	**Approved**	**Denied**	**Returned to applicant without action**	**Pending action**
1. Dun & Bradstreet's information only[a]	16	8	1	6	1
2. Information from Customs Service	7	6	0	1	0
3. Information from intelligence agencies	1	1	0	0	0
Total	**24**	**15**	**1**	**7**	**1**

[a]That is, information sold by Dun & Bradstreet which Defense interpreted as adverse. Dun & Bradstreet does not make recommendations on the suitability of end users for export control purposes

As shown in table 2.3, Defense interpreted information provided by Dun & Bradstreet as indicating suspicious end users on 16 applications. Commerce approved 8 of these applications. We discussed the bases of these decisions with Commerce's licensing officials, who said that Commerce generally approved the applications because they appeared to describe routine transactions. The commodities, for example, were relatively unsophisticated; the volume and dollar amounts of the proposed exports were relatively low; the end users were not identified by OEE as suspicious; and Defense's denial recommendations were thought to be too general to be useful. However, Commerce's licensing decisions were made without knowledge of some potentially relevant information. As discussed below, Defense generally did not share with Commerce all the information it used in support of its denial recommendation. For the 16 Dun & Bradstreet related cases, Defense interpreted Dun & Bradstreet's information as "adverse" for the following reasons.

1. In 9 cases, end users did much of their business in the People's Republic of China. Defense, however, supported its recommendations to Commerce only with the notation "inadequate [or "insufficient"] end use information." Commerce did not consider such a notation sufficient to sustain Defense's denial recommendations and, in the absence of any related information that it considered adverse, approved 4 of these 9 applications. It returned 5 to applicants without action, 4 of which involved the same end user. OEE had recommended that these 4 applications be denied, but the applicant withdrew the applications before a licensing decision could be made. The remaining application was returned because it did not contain all of the required documentation.

2. In 4 cases, end users did not appear to exist at the address given on the application and in 3 of these cases, the end user also did not appear

to be registered as a business in the country of destination. Defense told Commerce that lack of an address was the basis of its denial recommendation in only one of the 4 cases. Commerce approved 2, denied one, and returned one to the applicant without action. In one approved case (see app. I), Commerce granted a license prematurely because Defense told Commerce that the end user did not appear to exist but Commerce did not attempt to verify this information. In the other approval case, Defense did not tell Commerce that the end user did not exist, only that there was "insufficient end user information" and "inconsistent product information," which meant that the information on the Hong Kong import certificate[7] was not the same as the information on the license application. The end user in this case was not on OEE's list of suspicious end users. Commerce's licensing office had a copy of the import certificate, but Defense did not send it a copy of the Dun & Bradstreet report on the end user. The application that Commerce denied is discussed on page 21. Commerce returned one application without action when U.S. authorities in Hong Kong did a pre-license check and reported that they were unable to find any information on the end user. The pre-license check was made in response to Defense's notation in support of its denial recommendation, i.e., "pre-license check on end user."

3. In 2 cases, end users' business activities were not consistent with the end use statements on the applications. Defense supported its recommendations only with the notations (1) "inadequate information on ultimate end user" and (2) "Consignee does not sell computers." Commerce approved the first application, and the second was still pending as of December 31, 1985. In the case Commerce approved, Defense's internal memorandum stated that the end user was an importer and not a manufacturer. The application's end-use statement, however, said that the importer, a manufacturer, was an affiliate of the end-user's (importer's) firm. Following Defense's recommendation, OEE made a pre-license check of the end user at the request of the Commerce licensing officer in charge of the case. The pre-license check report stated that a U.S. counsular official found no derogatory information about the end user and was of the opinion that the end user intended to use the product in the country of destination. The application was approved on the basis of the pre-license check.

[7]Import certificates are issued by the importing government at the request of the importer, who sends a copy to the exporter who must submit it to the exporting government (i.e., U.S.) with the export license application.

4. In one case, Defense believed that there was insufficient information about the end user and supported its denial recommendation with the notation "relatively little information on end use. Cost of commodities is half of company's worth. High Technology." Commerce approved the application with the condition that distribution or resale of the products (integrated circuits) was permitted only in the country of destination.

Defense also recommended that 8 other applications be denied because the end users were the subjects of Customs Service investigations (7 applications) or because of information provided by one or more intelligence agencies (1 application). Commerce had adverse information about two of these end users, accounting for 5 of the 8 applications, but believed that it was not sufficient to warrant denial actions. (See apps. III and IV for licensing histories involving both end users.) Commerce approved 2 of the remaining 3 applications and returned one to the applicant without action because the product's description was in a foreign language. Commerce approved the 2 applications without the benefit of the specific information Defense had. Defense neither told Commerce that the end users were under investigation by the Customs Service nor conveyed any information about the investigations themselves. For one of these 2 applications, Defense justified its denial recommendation only by the notation, "lack of specificity on end user." Defense's recommendation in the case returned without action was based on its suspicion that the end user was diverting controlled products to the Soviet Union. Defense, however, did not share the basis of its suspicion with Commerce.

Until July 1985, Commerce officials did not seek information directly from the Customs Service about the investigations that Defense was using as the basis of denial recommendations. Commerce officials believed that Defense, as the agency making licensing recommendations to Commerce, was responsible for supporting such recommendations with specific information about any Customs Service information it used. In July 1985, Defense began providing Commerce with Customs investigatory case numbers. Commerce, in turn, began requesting information about such investigations from Customs, such as the degree of Customs enforcement concern. Additionally, a list of all Customs investigations is provided monthly to OEE and it inspects the list for export control-related cases. As a result of this inspection, a number of names have been added to OEE's list of suspicious end users.

OEE, however, does not make licensing recommendations based solely on whether a party to an export transaction is under Customs investigation. The level of enforcement concern is important to OEE. An OEE official told us that, typically, when Defense's recommendations based on Customs information were discussed with Customs officials, Customs expressed no significant enforcement concern.

Commerce denied only one of the 24 applications that Defense wanted to deny, because of a suspicious end user. In this case, Dun & Bradstreet's report said that the end user did not exist at the address given on the application and was not registered as a business in Hong Kong. Defense, however, did not convey this information to Commerce with its recommendation. Rather, it based its recommendation on what it called "inadequate end use information." The end user, in fact, already was on OEE's list of suspicious end users. OEE requested a pre-license check of the end user by U.S. authorities in Hong Kong, which confirmed that it was an unsuitable recipient of U.S.-origin, national security controlled, commodities.

Evaluating the End Use: the Resale Issue

Concern over end use was used to support 31, or 52 percent, of Defense's 60 recommendations for denials, as shown in table 2.4. The basis for denying 27 of these 31 applications was resale by end users to customers unknown to U.S. licensing authorities in certain "problem" countries. Under export administration regulations, end users may import controlled products for resale within the country of destination unless specifically prohibited from doing so by Commerce. Commerce can, but generally does not, request the identity of the actual end user when products are exported for resale under the authority of individual validated licenses.

Table 2.4: Disposition of Defense Recommendations to Deny License Applications Based on Concerns About End Use[a]

		Commerce Licensing Actions			
Bases of Defense recommendation	**Number of applications**	**Approved**	**Denied**	**Returned to applicant without action**	**Pending action**
1. Products to be resold in country of destination	27	19	1	6	1
2. Products to be re-exported from country of destination	3	2	0	1	0
3. Other[b]	2	1	0	1	0
Total	**32**	**22**	**1**	**8**	**1**
Number of actual applications	31	21	1	8	1

[a]Numbers on table refer to license applications, but because Defense sometimes cited more than one reason for its recommendation there is necessarily some double counting. The magnitude of double counting is reflected in the two sets of column total figures. Defense recommended denial for one application that Commerce approved because end use was both for resale and re-export, and it is thus double counted.

[b]One end-use statement was transmitted incompletely from Commerce, and one such statement was not on the application as required.

Defense, however, does not believe that a distributor should be treated the same as an actual end user when granting an individual validated license. This position was clearly stated in an October 25, 1985, letter from Defense's Deputy Under Secretary for Trade Security Policy to his Commerce Department counterpart. The problem, as he saw it, which exists when the actual end users were not identified, was explained and he wrote that:

"Until we begin to receive more explicit information from exporters that the products are going to an identifiable actual end user for a specific purpose, Defense will recommend denial for applications of this nature for these [two] destinations."

His concern over "for resale" as the end use was re-emphasized in a hearing 2 weeks later before the Subcommittee on International Economic Policy and Trade, House Committee on Foreign Affairs. Defense has continued to recommend that such applications be denied. For example, of the 38 applications that Defense recommended be denied during the November 18 to 22, 1985 period, 31 involved resale to unidentified end users.

Commerce in most circumstances believes that it cannot deny a license application solely on the grounds that the end user intends to resell an item within the country of destination to customers who are unknown to U.S. licensing authorities. Before May 1985, Commerce's export licensing procedures required the identification of ultimate end users if

an item proposed for export was an "advanced computer." However, Commerce officials issued additional instructions to their licensing staff in May 1985 to restrict approval of some applications where the end use was for resale to unknown customers. The staff was directed not to approve applications involving products in four commodity categories thought to be of special interest to the Soviet Union and other countries and defined by certain operating characteristics. Licensing personnel also were directed to (1) return such applications to the applicants without action and request information about the distributors' customers or (2) approve the applications but require the distributors (end users) to seek the permission of the U.S. government to resell the previously licensed items. In this latter situation, Commerce approves a license application but withholds approval of the end use (i.e., resale). The end user is permitted to receive an item but not to dispose of it without U.S. government approval, and such permission may be contingent on the applicant identifying the end user's customers.

Commerce did not use these kinds of restrictions on any of the 19 approved applications that Defense recommended be denied because the end use was for resale. Commerce, however, returned one other such application without action because the quantity shown on the license application was different from the quantity on the import certificate. Commerce asked the applicant to resolve the discrepancy and to identify the end user's customers. Also, as discussed on page 16, Commerce denied two applications approved by Defense because the end user would not divulge the names of its customers as part of a pre-licensing check.

In January 1986, a joint Commerce-Defense task force began to discuss the resale issue. By March 1986, the agencies had agreed in principle that identification of distributors' customers would be required for especially sensitive products before export license applications could be approved. For other, less-sensitive products, distributors would be required to maintain special records of their transactions. For the least sensitive products, distributors would be able to resell items without identifying their customers or keeping special records. Pursuant to this agreement, Defense is determining how each commodity control category should be divided among the three different groupings.

Conclusions

Commerce and Defense were divided in their assessments of the diversion potential of specific end users, mainly due to disagreement on a number of general issues related to the appropriateness of exporting to

certain kinds of end users under certain conditions. The most important of these was the resale issue. Steps toward resolving this issue have been taken with the agreement in principle to designate three different categories for control purposes for items shipped to distributors; this has resulted in the precedent which makes writing licensing guidelines a shared responsibility of the Commerce and Defense departments.

On occasion, Commerce officials also interpreted other end-user-related information differently than did Defense officials. Commerce, for example, did not believe that it should deny an application solely because the Customs Service or some other agency was investigating an end user, without considering the seriousness of any investigatory concerns. Defense, on the other hand, recommended denial of applications solely on the basis of such investigations. As another example, Defense officials recommended denial of some applications because end users in Hong Kong regularly did a substantial part of their business with customers in the People's Republic of China. Commerce officials did not believe that they should deny applications solely on this basis.

In some cases, licensing decisions were made without some information available because Defense was not sharing with Commerce all of the information it used to support its recommendations, including its Dun & Bradstreet reports and information about Customs Service investigations. Also, Commerce was not always developing this information. These kinds of information-sharing problems, however, were largely resolved by the end of 1985, and Commerce is now getting more specific information from Defense.

The actions taken by Commerce and Defense to better coordinate efforts through improved sharing of information and resolution of the policy differences raised over the past year should lead to greater consistency between Defense's licensing recommendations and Commerce's licensing actions. A high level of consistency in future reviews will raise the question of whether Defense review of individual free world license applications should be continued in its present form.

Agency Comments and Our Evaluation

Defense questioned the representativeness of our April 1985 test period in part because a team to process license applications had yet to be assembled in April 1985. Defense further noted that it was not until August 15, 1985 that the "Free World Team was in place and in a position to really begin tightening up on the process." We believe that our observations on licensing are generally valid for the April to December

1985 period. In addition to the April test period, we made verification checks in May, June, and July. Generally, Defense requests for detailed information from Commerce and its recommendations to Commerce during these three periods were similar to those for April. For example, during the April period, Defense requested detailed information on about 28 percent of the applications it reviewed, and the average request rate for the following three 2-week periods was 35 percent. During the April period, Defense recommended that about 9 percent of the applications it reviewed be denied and, for the following three periods, recommended denial for about 7 percent.

We also examined the basis of Defense's denial recommendations for November 18 to 22, 1985. We found that most of the applications denied during this period were denied for essentially the same reason as the applications we reviewed in April. The basis of Defense's denial recommendations did not materially change between April and December 1985, when we stopped collecting data. It should be noted that applications initially reviewed by Defense in April were sometimes not decided upon by Commerce until June or later. Indeed, five of the applications we reviewed were still pending licensing decisions as of December 31, 1985.

Commerce agreed with our findings and observed that the evidence in the report appears to call into question the justification of Defense's review of license applications to free-world destinations. Commerce added that, based on this evidence, our conclusions on Defense's role "should be stated more explicitly." However we do not believe that issue can be more directly addressed until there is a high level of consistency between Defense's recommendations and Commerce's licensing actions.

Defense disagreed with our conclusion concerning consistency in licensing, stating that the "issue is not consistency but rather the quality and effectiveness of the review." Defense claimed that "substantial value has been added to the overall licensing process through Defense review of Free World cases."

We do not believe that "consistency" and "effectiveness" are mutually exclusive concepts, and we do not contend that Defense has not made a contribution to the current licensing process. The focus of our conclusion is on the future licensing process and its evolution toward a high level of consistency between Defense's recommendations and Commerce's decisions. If attained, it will be reasonable to question such a duplicative process and, since the broader responsibilities in the export licensing

process are Commerce's, the question will likely focus on whether or not to continue Defense's role in its present form. This question, of course, would not extend to Defense's role in continuing to assess the military significance of exports.

Licensing History of Application to Export Computers to an Asian Country

1985

March 29: Application received in Commerce's Office of Export Administration (OEA).[1] The value of the equipment was more than $1 million for resale in the country. The end user was not on lists of suspicious or bad end users, so OEE did not review the application.

April 1: Information from the application was sent electronically to Defense and evaluated against its various "screens."

April 9: A copy of the license application was sent to Defense at its request. Defense requested information on the end user from Dun & Bradstreet on April 15.

April 15: Dun & Bradstreet reported that the end user did not exist at the address it was given. The address on the license application was the same as that on the import certificate issued by the country's government,[2] suggesting that the U.S. license applicant had not erred in recording the end user's address.

April 29: Defense notified OEA that it recommended that the application be denied on the grounds of inadequate end-use information and the fact that the end user appeared to be non-existent. Defense did not send OEA a copy of the Dun & Bradstreet report or explain why resale within the country constituted an inadequate end use under export administration regulations.

May 30: OEA issued the export license. OEA officials did not believe that Defense had supported its recommendation with specific information as required, in their view, by the Presidential directive.

Subsequently the intelligence community developed adverse information about the end user but, as of December 1, 1985, it had not permitted Commerce to place this name on OEE's list of suspicious end users.

[1]Now called the Office of Export Licensing.

[2]Import certificates are issued by the importing government at the request of the importer, who sends a copy to the exporter, who must submit it to the exporting government (i.e., U.S.) with the export license application. In this case, the importer declared that the computer systems were for resale in the country. The Asian country's government notified the importer on the certificate that the goods were for use in the country, that diversion en route to the country was prohibited, and that re-export was prohibited unless authorized by the country's government.

Licensing History of Application to Export Computers to an Asian Country

1985	April 9: Application received in OEA. The value of the equipment was less than $500,000, for resale in the country only. The end user was not then on OEE's list of suspicious or bad end users, although currently it is on the list.
	April 11: Information from the application was sent electronically to Defense and evaluated against its various "screens."
	April 17: A copy of the license application was sent to Defense at its request. Defense also requested and received financial and other business-related information from Dun & Bradstreet. The Dun & Bradstreet report said that the firm purchases computer parts from abroad and re-exports about 70 percent of them to the People's Republic of China.
	May 8: Defense notified OEA that it recommended the application be denied because of inadequate end use information. Presumably, the basis of Defense's concern was the end user's business relationship with the People's Republic of China. Defense did not send OEA a copy of the Dun & Bradstreet report or indicate the specific source and/or nature of its concern other than the phrase "inadequate end use information."
	May 23: OEA issued the export license with a condition requiring the license holder to provide OEA with a document verifying delivery of each shipment made against the license. OEA officials issued the license because they did not believe that Defense had supported its recommendation with specific information as required, in their view, by the Presidential directive.

Licensing History of Application to Export Integrated Circuits to a European Country

1985	April 9: Application received in OEA. The value of the equipment was less than $50,000, for resale to two specific firms (ultimate end users) in the country. The specified end user was not on OEE's list of suspicious or bad end users, but one of the two ultimate end users was on this list. April 10: Information from the application was sent electronically to Defense and evaluated against its various "screens." April 17: A copy of the license application was sent to Defense at its request. Defense also requested and received financial and other business-related information on the end user from Dun & Bradstreet during April. In an internal memorandum, Defense officials stated that the applicant was under investigation by the Customs Service and that one of the ultimate end users allegedly was involved in diversions. May 8: Defense notified OEA that it recommended the application be denied on the grounds that the applicant was under investigation. Defense did not provide any additional information. April - May: OEE requested a pre-licensing check on the suspicious ultimate end user, and the results indicated that it was a suitable recipient of U.S.-origin controlled products. May 25: OEE told OEA that it did not have any concerns with the application. June 21: OEA issued the export license with a condition that the integrated circuits can be resold only in the country. An OEE official said that he interprets the intelligence information about the suspicious ultimate end user differently than Defense officials. However, because of concern about this firm, OEE subsequently asked the country's government to conduct a post-shipment check on the ultimate end user. As of December 1, 1985, the result of this check was pending. Since June 1985, OEE has been deferring action on all applications involving the suspicious ultimate end user until it receives the results of the post-shipment check.

Licensing History of Application to Export Computers and Related Equipment to a European Country

1985

April 10: Application received in OEA. The value of the equipment was less than $200,000, for resale in the country. The end user was on OEE's list of suspicious or bad end users.

April 11: Information from the application was sent electronically to Defense and evaluated against its various "screens."

April 22: A copy of the license application was sent to Defense at its request. Defense requested information on the end user from Dun & Bradstreet and the Customs Service at approximately this time. Defense received financial and other business-related information from Dun & Bradstreet and did not interpret any of it as adverse. The Customs Service, however, said that it was investigating the end user.

May 14: Defense notified OEA that it recommended that the application be denied on the grounds that the "end user is suspect." Defense did not tell Commerce anything further about the basis of its recommendation. According to an OEE official, the end user had been on its list of suspicious end users for some time, but in his opinion the derogatory information about the end user was not conclusive. Furthermore, pre-license checks in February and April 1985 did not reveal any derogatory information. Commerce has not made any post-shipment checks of this firm because the products exported to it are not considered especially militarily significant by OEE officials.

May 21: OEE told OEA that it did not have any concerns with the application.

June 20: OEA issued the export license.

Comments From the Department of Commerce

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

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UNITED STATES DEPARTMENT OF COMMERCE
The Assistant Secretary for Administration
Washington, D.C. 20230

JUL 03 1986

Mr. J. Dexter Peach
Director, Resources, Community, and
Economic Development Division
United States General
Accounting Office
Washington, D.C. 20548

Dear Mr. Peach:

This is in reply to GAO's letter of May 16, 1986, requesting comments on the draft report entitled "Export Licensing: Commerce-Defense Review of Applications to Certain Free-World Nations."

We have reviewed the enclosed comments of the Under Secretary for International Trade and believe they are responsive to the matters discussed in the report.

Sincerely,

Kay Bulow
Assistant Secretary
for Administration

Enclosure

UNCLASSIFIED WHEN CLASSIFIED
ENCLOSURE IS REMOVED

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UNITED STATES DEPARTMENT OF COMMERCE
The Under Secretary for International Trade
Washington, D.C. 20230

June 30, 1986

Dear Mr. Peach:

Thank you for the opportunity to comment on the General Accounting Office (GAO) draft report, "Export Licensing: Commerce-Defense Review of Applications to Certain Free World Nations." (U)

We agree with GAO findings that (1) approaches to resale continue to divide Commerce and the Department of Defense (DOD), (2) Commerce places a different emphasis on the relevancy of continuing investigations (i.e., Commerce argues that one must consider the seriousness of the investigatory concerns), and (3) DOD must share all relevant information and submit its recommendations to Commerce with specificity. (U)

While these findings identify the most divisive issues between Commerce and DOD, the evidence in the report appears to call into question the justification of the DOD West-West Review. Based on this evidence, it seems that GAO's conclusion on DOD's role in West-West review should be stated more explicitly.

On the issues of sharing information and specificity, it should be mentioned that, consistent with the spirit of Section 12(c) (3) of the Export Administration Act, all pertinent and available information should be provided by DOD to the licensing and enforcement authority (i.e., Commerce). Any failure of DOD to share some pertinent information with Commerce, which could materially affect a licensing decision, jeopardizes rather than enhances national security. (U)

See comment 1.

While DOD has generally provided Commerce with a conclusive basis for its recommendations on directive cases, it has rarely been sufficiently specific or forthcoming with sufficient information to support its recommendations. This lack of specificity continues to delay case processing.

For cases where DOD has used Dunn and Bradstreet information as a basis for recommending denial, such information may not provide a basis for denial. For example, in the cases where DOD recommended denial because "the firm frequently conducts business with the People's Republic of China (PRC)," the GAO report should reflect the U.S. Government policy on which the final licensing decisions are based.

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See comment 2.

See comment 3.

Enclosed are several additional points of clarification. I hope you find our comments useful. (U)

Sincerely,

Bruce Smart

Bruce Smart

Mr. J. Dexter Peach
Director for Resources, Community
and Economic Development Division
U.S. General Accounting Office
Washington, D.C. 20548

Enclosure

~~CONFIDENTIAL~~

The following are GAO's comments on the Department of Commerce's letter dated June 30, 1986.

GAO Comments

1. Information classified by the Department of Commerce has been deleted.

2. Information classified by the Department of Commerce has been deleted.

3. These points, some of which were classified, have been addressed in the report, where appropriate.

Comments From the Department of Defense

OFFICE OF THE UNDER SECRETARY OF DEFENSE

WASHINGTON, D C. 20301-2000

1 JUL 1986

POLICY

In reply refer to:
I-10852A/86

Mr. Frank C. Conahan
Director, National Security and
International Affairs Division
U.S. General Accounting Office
441 G Street, N.W.
Washington, D.C. 20548

Dear Mr. Conahan:

This is the Department of Defense (DoD) response to the General Accounting Office (GAO) draft report entitled, "EXPORT LICENSING: Commerce-Defense Review of Applications to Certain Free World Nations," dated May 16, 1986 (GAO code 483418/OSD case 7018).

On January 4, 1985, the President approved the coordinated review of export license applications by the Departments of Defense and Commerce for eight Commodity Control List categories to fifteen Free World destinations. Defense began receiving its first cases for review electronically from Commerce under this agreement on February 15, 1985. The Defense Automated Case Review Systems (DACRS) had been designed and developed as a prototype to receive, review, store, and process cases transmitted electronically from the Commerce Licensing Automated Retrieval System (LARS). Thus, the initial review of cases would serve to test the DACRS system.

Defense had just begun its Presidentially directed review of Free World cases when the GAO performed its review of cases. At that time the GAO was advised by Defense officials that the study was premature and would not be representative because (1) the administrative and technical filters of the DACRS system were still being set, (2) the feasibility of a commercial data base was under review, and (3) a team to process these cases had not yet been fully assembled. Existing personnel assigned to other duties were handling processing in the interim, keeping track of cases and assuring that Defense was adhering to the strict deadlines mandated by the Presidential Directive. Also, Defense was just beginning to analyze its findings and the major issues that were emerging.

At the time the GAO evaluated the 671 license applications sent from Commerce to Defense (April 1-12, 1985), Defense had received only 1800 applications for processing. In contrast, by the first anniversary of DACRS operation on February 15, 1986, 15,478 cases had been reviewed and processed within the Presidentially mandated deadlines.

While the GAO also reviewed applications for the first two weeks of May, June, and July 1985, Defense had reviewed only 2,548, 3,765 and 5,125 cases for those periods, respectively. In addition, permanent staff was still being brought on board during those periods. It was not until August 15, 1985, that the Free-World Team was in place and in a position to really begin tightening up on the process. Considerable progress has, therefore, been made since the GAO review.

Substantial value has been added to the overall licensing process through Defense review of Free-World cases. For this reason it is far more desirable for Defense to review all Free-World cases to assure enhanced national security of technology transfer. No other department of the Federal Government is in a position to make such an evaluation. The purpose of such a review is not only a significant tightening of the license process which is beginning to occur but, more importantly, to protect the national security in technology transfer matters, a responsibility given to Defense under law and by the President. Defense, therefore, differs with the GAO conclusion concerning consistency in licensing actions because the issue is not consistency but rather the quality and effectiveness of the review. The quality of the review is being substantially enhanced by the DoD involvement in the licensing process.

Detailed DoD comments on each finding are provided in the enclosure. In addition, at the June 18, 1986, meeting with the staff from the National Security and International Affairs Division, other general observations were provided. Thank you for the opportunity to comment on the draft report.

Sincerely,

Dr. Stephen D. Bryen
Deputy Under Secretary
Trade Security Policy

Enclosure

GAO DRAFT REPORT - DATED MAY 16, 1986
(GAO CODE 483418) OSD CASE 7018

"EXPORT LICENSING: COMMERCE-DEFENSE REVIEW OF APPLICATIONS TO CERTAIN FREE WORLD NATIONS"

DEPARTMENT OF DEFENSE COMMENTS

* * * * * *

FINDINGS

FINDING A: THE EXPORT CONTROL SYSTEM. The GAO reported that under the Export Administration Act of 1979, as amended, the Secretary of Commerce administers the control of the export of militarily significant commercial products and issues export licenses. The GAO observed, however, that section 10 (g) of the Act also includes "special procedures" for the Secretary of Defense to review some kinds of export license applications. The GAO found, however, that because the Act did not specifically define countries "to which exports are controlled for national security purposes," the exact scope and nature of the DoD review responsibilities has been a matter of continuing conflict between the Departments of Commerce and Defense. To resolve this conflict, the GAO reported that in January 1985 the President issued a directive, which added to the scope of the DoD review of export applications--i.e., in addition to reviewing proposed exports to the Soviet bloc and China, the DoD now reviews all applications for eight product categories exported to 15 free-world destinations. The GAO also noted the directive authorized the establishment of a Technology Transfer Steering Group, composed of officials from Commerce, Defense, and the National Security Council, to resolve disputes between Commerce and Defense over licensing recommendations related to the directive. The GAO found, however, that through December 31, 1985, the Steering Group had held only one meeting. The GAO asserted that the lack of meetings understates the differences that exist between Commerce and Defense. (p. 1, pp.7-10/GAO Draft Report)

Now on p. 10

DOD RESPONSE: PARTIALLY CONCUR. The DoD disagrees with the GAO statement concerning the lack of Steering Group meetings. The lack of meetings by the Technology Transfer Steering Group is attributable to a variety of factors other than differences between the two departments. Defense approached its new responsibility for review of applications to certain Free World nations as an opportunity to strengthen and improve the licensing process. It has sought to establish a good working relationship with its Commerce counterparts. It has been educating itself on the process and analyzing major issues and differences to evaluate the best

possible approach to critical licensing matters. Commerce has new leadership and Commerce staff are cooperative. As a result, several issues are on the way to some form of mutual resolution. Working groups have met to discuss case problems and major issues, which have been reviewed by the Assistant Secretary of Commerce for Trade Administration and the Deputy Under Secretary of Defense for Technology Security Policy, among others. This does not mean that Defense at some future time will not refer serious issues to the Technology Transfer Steering Group. Defense remains concerned over the Commerce Department's unilateral override of its recommendations, which violates the spirit and intent of both the Presidential Directive and the Export Administration Act. Most recently though, cases involving extremely sensitive technology have been resolved through further technical analysis and consultation between the two organizations without the need for any escalation.

FINDING B: IMPLEMENTATION OF PRESIDENTIAL DIRECTIVE. The GAO reported that in response to the Directive, the DoD has established a procedure to automatically screen the applications received from Commerce. According to the GAO, the DoD electronically compares information on applications with (1) a list of individuals and firms considered potential diverters, (2) countries with questionable export control procedures, (3) characteristics which define a product's sophistication, and (4) questionable addresses of the end users (such as a "P.O. Box"). The GAO reported that the purpose of these screens is to help the DoD identify quickly those applications which should be reviewed in detail for policy and technical reasons. The GAO noted that the DoD has seven calendar days or 15 additional working days for further review, if needed, to review applications and make recommendations to Commerce. The GAO found that at the time of its test period, April 1 to 12, 1985, the DoD was not routinely being informed of Commerce licensing actions on the applications reviewed by the DoD. The GAO noted, however, that in late 1985, Commerce began routinely notifying the DoD of its proposed licensing decisions when they were contrary to DoD recommendation. Although the GAO did not assess the administrative efficiency of the export licensing process, the GAO also found that both the DoD and Commerce (1) purchase information from Dun & Bradstreet, (2) collect end-user related information from other U.S. Government agencies, and (3) maintain lists of suspicious end users. The GAO also observed that DoD and Commerce do not share the information they develop from lists of suspicious end users. (pp. 1-2 and pp. 16-19, GAO Draft Report)

Now on pp. 3, 13, and 14

DOD RESPONSE: PARTIALLY CONCUR. Until software was available in the Commerce System in March 1986 that enabled Defense to return cases to Commerce electronically, Defense had no way of knowing the final disposition of applications by Commerce. Commerce has never, however, routinely advised Defense of its actions on Defense recommendations. This situation still exists with respect to

Defense recommendations on East-West cases today where there is no data link. When it finally became possible to track the final electronic disposition of Free World cases, a wide disparity was noted. An analysis is being completed by Defense and will be shared with Commerce with the intent of all questioned actions being dealt with and accounted for. A closer liaison between Defense and the Office of Export Enforcement at Commerce has furthered a greater sharing of information, and as Defense has begun to develop its own intelligence data base, it has shared its information with greater specificity. It is important to keep in mind that the sharing of information on suspicious end users between the two departments is hampered somewhat by security procedures. While the Free World case processing team at Defense has the necessary clearances and direct access to intelligence data, the number of individuals cleared at top levels of access in Commerce are limited and facilities are limited.

FINDING C: APPLICATIONS FOR WHICH DOD RECOMMENDED APPROVAL. The GAO reported it reviewed 671 license applications sent to the DoD from Commerce during the period April 1 to 12, 1985. (The GAO noted that DoD actually received information on 694 applications, but three of them were not covered by the Presidential Directive's criteria, and Commerce returned twenty applications to the applicants without action before the DoD asked for copies.) The GAO found that the DoD recommended approval for 611 or 91 percent of the 671 applications that it reviewed. The GAO also found that of the 611 DoD approved applications, Commerce approved 482 or 79 percent, returned 118 without action and denied seven or about 1 percent. The GAO reported the following reasons for the denied applications:

-- one was denied for foreign policy reasons;

-- another was denied on the basis of pre-existing intelligence agency reports which indicated that the end-user was not a suitable recipient of U.S.-origin national security controlled commodities; and

-- the other five were denied on the basis of unfavorable pre-license checks of the end users by U.S. embassy officials overseas. (p. 3, p. 11, pp. 19-22/GAO Draft Report)

Now on pp. 3, 4, 15, and 16.

DOD RESPONSE: CONCUR. While Defense does not argue with the GAO analysis of the 671 license applications, the analysis may not, however, be representative because the period covered (April 1-12) was quite early in the start up of the program. Defense was starting from scratch with no list of end users and no prior data base of intelligence information on questionable end users. In addition, the DoD did not have access to a file of end user checks by U.S. embassy officials overseas. Defense was clearly in a learning mode and a permanent staff was in the process of being recruited.

FINDING D: APPLICATIONS FOR WHICH DEFENSE RECOMMENDED DENIAL--EVALUATING THE END USER. The GAO found the DoD recommended that Commerce deny 60 export license applications, but Commerce generally disagreed with the DoD denial recommendations and approved 39, or 65 percent, of the 60 applications. (Table 2.2 on page 23 of the GAO Draft Report lists the various reasons for the DoD recommended denials, as well as the Commerce actions). The GAO pointed out that almost half, or 24 of the 60 DoD recommended denials were based on DoD concerns that the end users might illegally divert controlled products. The GAO reported these concerns were based on DoD interpretation of information received from Dun & Bradstreet, the U.S. Customs Service, and one or more intelligence agencies. The GAO found, however, that the DoD generally did not share with Commerce all the information it used to support a recommendation, and the DoD generally based its denial recommendations on general notations of concern, rather than on specific adverse information. As a result, the GAO found that for those applications that the DoD officials wanted to deny, Commerce concurred only when the DoD provided sufficient specific information to justify a negative determination. The GAO found that, as result, Commerce denied only one of the 24 applications that the DoD wanted to deny because of a suspicious end user. According to the GAO, the Presidential Directive states that the DoD objections to issuing an export license must be made "with specificity." The GAO found, however, that Commerce and DoD officials have differed over what this phrase means, with the result that Commerce has approved some applications which DoD recommended be denied because, according to Commerce officials, their requests for more specificity were not met by DoD. The GAO also found that neither Commerce nor DoD referred applications to the Steering Group established by the directive to resolve disputed applications. (The GAO did point out, however, that DoD began supporting its recommendations with more specific information later in 1985.) The GAO concluded that, because Commerce and Defense officials interpreted export license information differently, and because Defense did not share information in some cases or Commerce was not always developing information, Commerce approved most license applications that Defense wanted to deny, and denied some licenses that Defense wanted to approve. The GAO further concluded, however, that the information-sharing problems were largely resolved by the end of 1985, and Commerce is now getting more specific information from Defense. The GAO also concluded these actions should lead to greater consistency between Defense licensing recommendations and Commerce licensing actions. On the other hand, the GAO concluded that a high level of consistency raises the question of whether Defense review of individual Free World license applications should be continued in its present form. (pp. 2-4, pp.22-30, pp. 35-37/ GAO Draft Report)

Now on pp. 3, 4, 15-21, 23, and 24.

DOD RESPONSE: PARTIALLY CONCUR. The GAO findings fail to take into consideration that Defense had just embarked on an ambitions

program which was begun from scratch. Defense recommendations of denial were based on concerns because specific information was lacking and still in the process of development. In some instances where specifics were supplied, Commerce still unilaterally approved cases without notification, violating the spirit and intent of the Presidential Directive. In one group of cases, in a period not covered by the GAO review, the DoD "expressions of concern" were later supported by indictments and Commerce had to rescind the licenses after they had been issued. Disputed licenses were not referred to the Technology Transfer Steering Group because Defense in many instances had no way of knowing which ones were in dispute. The GAO correctly notes that information sharing problems have been largely resolved due to hard work and cooperation between the two departments. Defense does not agree with the GAO conclusion that a high level of consistency raises the question of whether continued Defense review of licenses should continue in its present form. The issue is not one of consistency, but rather one of quality and effectiveness of the review. The quality of the review is being substantially enhanced by the DoD involvement in the licensing process.

FINDING E: APPLICATIONS FOR WHICH DEFENSE RECOMMENDED DENIAL--EVALUATING THE END USE: THE RESALE ISSUE: The GAO found the DoD based another 31 of its 60 denials on concerns about end use. The GAO pointed out that the DoD basis for denying 27, or 87 percent of these 31 applications was resale by end users to customers unknown to U.S. licensing authorities in certain "problem" countries. The GAO reported that Commerce, in most circumstances, believes it cannot deny a license application solely on the grounds that the end user intends to resell an item within the country of destination to customers who are unknown to U.S. licensing authorities. (As noted in Table 2.4 on page 32 of the GAO Draft Report, Commerce approved 19 of the 27 applications that the DoD recommended be denied.) The GAO observed that in January 1986 a joint Commerce-Defense task force began to discuss the resale issue. The GAO reported that by March 1986, the agencies had agreed in principal that identification of distributors' customers would be required for especially sensitive products, before an export license application could be approved. The GAO reported that for other, less-sensitive products, distributors would be required to maintain special records of their transactions, and for the least sensitive products, distributors would be able to resell items without identifying their customers or keeping special records. The GAO noted that pursuant to this agreement, the DoD is determining how each commodity control category should be divided among the three different groupings. The GAO concluded that control over resale was the most important and particularly contentious issue between Commerce and Defense in 1985 and 1986. The GAO also concluded, however, that steps toward resolving this issue have been taken with the agreement in principle to

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Now on pp. 3 and 21-23.

designate three different categories for control purposes for items shipped to distributors. The GAO observed that a significant result from this approach to resolving the resale issue was the precedent of writing licensing guidelines as a shared responsibility of the Commerce and Defense Departments. The GAO further concluded the actions taken by Commerce and Defense should lead to greater consistency between the Defense licensing recommendations and the Commerce licensing actions. On the other hand, the GAO concluded that a high level of consistency raises the question of whether Defense review of individual Free World license applications should be continued in its present form. (pp. 2-4, pp. 31-37 GAO Draft Report)

DOD RESPONSE: PARTIALLY CONCUR. The daily abstracts of cases printed out by the DOD DACRS system revealed that exporters were simply stating that the proposed end use was for "resale." This was troublesome because large quantities of sensitive materials were being exported without adequate identification of the end user and end use. Verification of orders in many instances was simply not being provided. As a result, Defense has requested more information on the end use and the end user. Where this information has not been available, it has requested proof of firm orders and asked the exporter to keep records. The joint Commerce/Defense working group should have recommendations shortly on how to resolve this issue. There have been other issues raised that still must be resolved before the GAO conclusion on consistency in recommendations becomes a reality. Defense has questioned the use of the Individual Validated License (IVL) as a bulk license. It has been concerned about the potential for diversion of sensitive commodities through certain Pacific Basin destinations. At the suggestion of Defense, a joint U.S. Defense/Commerce/Customs Study Team will soon visit a number of these countries on a fact finding mission. Similar discussions have been proposed with another country on the administration of an existing Memorandum of Understanding (MOU). Defense review of Free World license applications must continue in its present form to resolve such key issues and to support an effective export control program.

RECOMMENDATIONS

NONE.

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