

**STATEMENT OF
JOHN C. PAYNE
DEPUTY INSPECTOR GENERAL FOR THE
U.S. DEPARTMENT OF STATE, AND THE UNITED STATES INFORMATION
AGENCY, INCLUDING INTERNATIONAL BROADCASTING**

**FOR THE
COMMITTEE ON GOVERNMENTAL AFFAIRS
U.S. SENATE**

June 23, 1999

Mr. Chairman and Members of the Committee:

Thank you for the opportunity to testify before your committee on the export licensing process for munitions and dual-use commodities. My testimony today is based on work we conducted in response to your August 1998 request to update and expand on the Office of Inspector General's (OIG's) 1993 interagency report related to export licensing. Our report answers the 14 questions you asked and discusses the Department of State's role in the interagency export licensing process for munitions and dual-use commodities.

SUMMARY

We found that, overall, the export licensing process is working as intended and the Department of State (State) consistently executed its export licensing responsibilities in accordance with established policies through its Office of Defense Trade Controls (DTC). In responding to your questions, we found no significant inconsistencies or ambiguities in the legislative authorities that guide the export licensing process. In addition, based on a valid statistical sample, we found that State consistently referred all appropriate munitions license applications to other agencies for review, and fully addressed the concerns raised. We found no evidence that State licensing officials had ever been improperly pressured by their superiors to approve license applications. Finally, we found that a reliable and adequate audit trail existed for both the processing of munitions and dual-use licenses at State.

However, our review identified areas for improvement, and recommended that State enhance the end-use monitoring program and expand training for licensing officers. Also, the current munitions and dual-use licensing processes do not fully measure the cumulative effect of technology transfers. Finally, a lack of resources negatively affects State's ability to fulfill its mandate.

End-use monitoring. DTC's formal process for conducting end-use checks is known as the Blue Lantern program. The program, which includes pre-license and post-shipment checks, was established in 1990 to verify the ultimate end use and end user of U.S. defense exports. Although DTC continues to refine its program, additional improvements can be made. For example, DTC should place more emphasis on the selection criteria used to initiate Blue Lantern checks. Second,

DTC should improve the timeliness of its end-use checks by more consistently monitoring and following up on its Blue Lantern requests. Finally, DTC should assist posts with appropriate expertise for technical on-site inspections.

Training for licensing officers. Licensing officers need additional training opportunities. DTC relies primarily on an apprenticeship approach and although this provides important hands-on training, there is no formal training available to provide new licensing officers with a broad overview of the export licensing process. Training for more senior licensing officers is limited, and they have little opportunity to participate in external training classes and industry outreach activities. Although we believe training should be improved, we did not identify any specific problems that resulted from a lack of training.

Cumulative effect of exports and technology transfers. The current munitions licensing process does not fully measure the cumulative effect of technology transfers resulting from the export of munitions items. DTC can improve its assessment of the cumulative effect by expanding the use of trend analyses and other reporting mechanisms. Nevertheless, DTC represents only one piece of a much larger picture. To assess the cumulative effect, information on technology transfers resulting from munitions and dual-use exports, foreign military sales, and third-country sales to foreign countries would need to be considered, as well as the internal capabilities of a specific country. A comprehensive assessment will probably require a joint effort with resources and coordination from various Federal departments and agencies involved in the licensing process.

Inadequate resources. Many of the concerns cited above are symptomatic of a larger problem at DTC -- insufficient resources to meet its expanding mandate. DTC has fewer employees and lower pay grades compared to other agencies involved in export licensing. DTC licensing officers have higher workloads and a lower journeyman grade level than their counterparts at the Department of Commerce (Commerce) and Department of Defense (Defense). In FY 1998, 16 DTC licensing officials processed 44,000 license applications, while at Commerce 47 licensing officials processed 13,500 applications. This has impeded DTC's ability to perform its munitions licensing responsibilities. The workload of licensing officers and the time needed to process licenses have increased, contributing to employee turnover and fewer training opportunities. The situation continues to worsen because DTC officially assumed responsibility for all commercial satellite cases from Commerce on March 31, 1999.

Recognizing the need for additional resources and the recent statutory change in commercial satellite responsibility, Congress recommended in the conference report accompanying the FY 1999 State Department appropriations bill, and in the conference report accompanying the emergency supplemental appropriations for FY 1999, that State provide DTC with a \$2-million increase over its FY 1998 budget of \$5,011,000, representing a 39 percent budget increase. Congress directed DTC to use this money to hire additional senior-level personnel at the GS 13-15 levels and support staff to improve the scrutiny of export license applications, enhance end-use monitoring, and strengthen compliance enforcement measures to ensure that U.S. technology is properly safeguarded when exported. State officials said that as of June 7, 1999, State increased DTC's budget by \$2 million over FY 1998 funding levels. DTC plans to add a total of 23 positions, however, as of June 18, 1999, DTC had only received authorization to hire 8 additional staff persons.

BACKGROUND

The United States controls the export of defense articles and services on the U.S. Munitions List under the authority of several laws, chiefly the Arms Export Control Act of 1976 (AECA). The AECA authorizes the President to provide U.S. foreign policy advice to U.S. citizens involved in the manufacture, export, and temporary import of defense articles and services. The AECA also requires that licenses be obtained before defense articles or services are exported and that such articles and services be designated on the U.S. Munitions List. Executive Order 11958 delegates the responsibility for administering the functions of the AECA to the Secretary of State. Within State, DTC in the Bureau of Political-Military Affairs (PM) is responsible for administering these functions, among others, on a day-to-day basis. Munitions commodities are generally products that have been specifically designed for military application. They include products such as aircraft, tanks, and rifles and services such as assistance to foreign persons in the design, development, manufacture, or engineering of defense articles. In FY 1998, DTC processed over 44,000 munitions license applications.

Commerce is the agency responsible for licensing dual-use commodities, which are commercial commodities that also have military application. State reviews, for foreign policy considerations, dual-use license applications referred by Commerce. During FY 1998, State reviewed over 8,000 dual-use license applications. This represents 75 percent of all license applications received by Commerce. At State, three offices in the Bureau of Nonproliferation (NP) play a role in the dual-use licensing process, with each office reviewing specific types of commodities. The Office of Chemical, Biological and Missile Technology reviews missile, chemical, and biological commodities. The Office of Nuclear Energy Affairs is the advisor for nuclear energy related commodities. Finally, the Office of Export Control and Conventional Arms Nonproliferation Policy reviews a wide variety of areas including foreign national access to U.S. technology, machine and semiconductor tools, super computers, encryption equipment, and night vision goggles. The Bureau of Economic and Business Affairs, Office of Energy, Sanctions and Commodities also reviews licenses for crime control, foreign policy, economic, and human rights concerns.

Previous OIG work on Defense Trade Controls

In 1993, OIG conducted a joint review of the Government's export licensing processes with Inspectors General from Commerce, Energy, and Defense. The review found a fragmented process for dual-use licensing responsibilities within State. The review also found confusion at overseas posts over responsibilities for end-use checks and verifications, and a lack of program files and documentation.

State has made improvements subsequent to the 1993 review, including the consolidation of dual use export license processing under NP, and improved documentation of the referral process. In addition, Commerce's referral of dual-use license applications to State has improved. The 1993 report called for Commerce, in cooperation with Defense, Energy, and State, to provide a mechanism for resolving referral criteria disputes at progressively higher levels and periodically review referral criteria. During our current review, State cited no problems with dual-use referrals.

FINDINGS

State's export licensing process is working as intended. Based on a valid statistical sample, we found State was properly referring appropriate munitions applications to other agencies for review, and was fully addressing concerns that were raised. For the applications referred outside DTC, the final licensing decisions incorporated the provisos recommended by reviewing agencies.

Munitions License Applications

DTC refers munitions license applications to Defense, Energy, and to other bureaus within State for technical, national security, or foreign policy review. Applications that require technical expertise to review, such as encryption devices, computer source code, or technical data are referred to Defense, which receives the majority of DTC referrals. Energy reviews cases related to nuclear weapons and explosive devices. Applications dealing with intelligence issues are referred to the State's Bureau of Intelligence and Research, and applications to countries with human rights concerns are referred to the Bureau of Democracy, Human Rights and Labor. In FY 1998, DTC referred approximately 27 percent of its munitions license applications outside of DTC for review.

We reviewed a sample of 100 munitions license applications from the period January - June 1998, 25 of which were referred outside of DTC. The primary purpose of the review was to determine whether license applications for munitions were properly referred outside DTC. We also assessed the adequacy and accuracy of the supporting license documentation and the criteria that DTC licensing officers use when processing license applications. The following table illustrates DTC's license referrals over the last 4 years.

DTC Munitions License Referrals

Fiscal Year	Total # Applications Received	# of Applications Referred Outside DTC	% of Applications Referred Outside DTC
1995	46,020	11,710	25.4
1996	45,783	14,518	31.7
1997	45,844	14,200	30.9
1998	44,212	11,955	27.0

Based on our review, DTC is properly referring munitions applications to other agencies for comment, and we found no cases where licenses should have been referred but were not. Furthermore, in all applications referred outside DTC, the final licensing decisions fully incorporated the provisos recommended by reviewing agencies.

Dual-Use License Referrals

State is also responsible for making recommendations on dual-use license applications that have been referred from Commerce. In FY 1998, DTC reviewed 8,101, which is 75 percent of all dual-use license applications. We reviewed a sample of 60 dual-use license applications referred to State during the period January - June 1998. We met with each of the officials responsible for

responding to the referred applications and evaluated State's response to each application and the extent to which Commerce's final position incorporated State's recommendations.

We examined the procedures that State used to respond to the 60 dual-use license applications and found no discrepancies between the recommendations that State made and the final licensing decision reached by Commerce. However, we found that one office did not enter an official opinion within the 30-day time limit on 5 of 31 (16%) of the applications in our sample, forfeiting its right to make a recommendation on the application. In FY 1998, one office did not meet the time limit and forfeited its vote on 1,224 of 4,500 cases (27%). NP officials stated that each application had been reviewed and they consciously decided whether to enter a formal position; however, there was no documentation verifying this information. NP officials also said that a formal position was not always entered within the 30-day time limit due to staffing shortages, but that additional staff were assigned to work on dual-use applications as a result of the recent merger with the Arms Control and Disarmament Agency. We believe State should continue to monitor this area to ensure that timeliness issues are addressed.

End Use Monitoring

DTC has a variety of procedures to ensure compliance with the conditions placed on export licenses. One of the primary checks is the Blue Lantern program, established in 1990 to ensure that U.S.-origin defense exports are sent only to the country of ultimate destination, for the specific end use and by the specific end user stated on the export license. We found that DTC could improve the Blue Lantern program by placing more emphasis on the selection criteria used to initiate Blue Lantern checks, more carefully monitoring the status of Blue Lantern checks, and assisting posts with adequate technical expertise when needed.

Selection Criteria

Currently, DTC uses a quota-like system for generating Blue Lantern checks, requiring licensing and compliance officers to develop one Blue Lantern check a week. Selection of the cases or items to be checked is usually left to the discretion of the licensing and compliance officers. The purpose of this is to ensure that DTC meets its goal of conducting approximately 500 checks a year. In FY 1998, DTC initiated 418 Blue Lantern checks. DTC officials stated that to reach their goal, they would like to increase the number of checks by approximately 20 percent.

In our view, the quality of checks is more important than the quantity, and there is little evidence that completing more checks will improve the effectiveness of the Blue Lantern program. DTC Blue Lantern program statistics from FY 1994-98 indicate that fewer than 10 percent of all Blue Lantern cases resulted in an unfavorable response, and that 26 percent were not responded to at all.

Overseas posts commented that DTC's criteria for initiating Blue Lantern requests were unclear. Posts also commented that some requests appeared to be insignificant both in terms of material and dollar value. DTC officials, for their part, contend that it is not practical to limit Blue Lantern requests to specified dollar levels because all Blue Lantern requests have some value. Although we agree that dollar value should not be the only factor in deciding to perform a check, we believe it should be considered when weighing the costs and benefits of initiating a check.

During our overseas fieldwork, we identified examples of Blue Lantern checks that appeared to be of minimal value:

- DTC requested one embassy to ascertain whether the host government's navy had ordered four common UHF radio antennas valued at approximately \$650 each. However, according to embassy personnel, these particular antennas, unlike more sophisticated aircraft antennas, are easily obtained on the local commercial market.
- DTC requested another embassy to make appropriate inquiries into the bona fides of an application for spare parts for the host country air force. The parts were for F-4 and F-5 aircraft, which the host country military is known to have in its inventory. The parts had a total value of \$3,924 and were described in the request as follows: 1- line, 1- oil inlet tube, 8- packing, 22 - packing, 9 - washer, 6 - field kit. The cable sent to post did not specify why this check was being initiated or its importance. An embassy official stated that it was unclear why these generic, inexpensive components for aircraft known to be part of the host country military would warrant a Blue Lantern check. The official stated that this check was not in the U.S. Government's best interest because if the post asks the host country military to research too many checks perceived as insignificant, the more important ones might not be taken as seriously.
- DTC requested another embassy to verify the bona fides of an application for approximately 300,000 steel bushings to be used as parts for the track shoe assembly of M113 armored personnel carriers, which are widely used around the world to transport people and supplies. The steel bushings cost approximately \$.55 each and are widely available on the local market.

Given the limited number of Blue Lantern checks conducted each year -- 418 checks out of over 44,000 licenses in FY 1998 -- DTC should concentrate its attention on the most significant munitions categories. Factors that could be considered when initiating Blue Lantern checks include cases where (1) the commodity will contribute to the development of weapons of mass destruction or significantly enhance the capability of a military, (2) there is a high risk of diversion, (3) the commodity/technology cannot easily be obtained within the country, and (4) the dollar value of the license is high enough that the potential benefits will exceed the costs to conduct the check. This is especially important given the posts' limited resources.

Inadequate Monitoring

DTC is not consistently monitoring and following up on the Blue Lantern requests that it tasks the posts to complete. For example, at two of the five posts we visited, little attention was given to the Blue Lantern program until the posts became aware of our visit. At one of the posts, there were five Blue Lantern checks that had not been addressed in almost a year, and there were several Blue Lantern checks at another post that had not been answered in over 4 months. In addition, one of the posts had not had a designated Blue Lantern official for over 6 months.

DTC should strengthen the procedures to ensure that Blue Lantern checks are completed in a timely manner. Procedures in place include periodic monitoring by a designated Blue Lantern coordinator and weekly meetings on Blue Lantern cases involving licensing and compliance

personnel. Compliance officers are responsible for monitoring timeliness, but each officer does it differently with insufficient oversight from DTC managers. One compliance officer characterized the monitoring as "the honor system," meaning it is up to the individual compliance officer to follow up with posts on unanswered checks. Another officer stated that it was not possible to closely monitor the status of the Blue Lantern checks because of time constraints. Furthermore, DTC managers do not receive any formal reports that indicate how long a case has been open. The consequence of not closely monitoring Blue Lantern checks, coupled with delays by posts in completing them, is that some checks remain open for excessive periods of time. For pre-license checks, which comprise 70 percent of the cases, this ultimately results in licenses taking longer to be issued. DTC's records showed approximately 153 Blue Lantern cases that were still in progress as of January 7, 1999. Twenty-six of these cases had been open for over one year; three were initiated in 1995.

Technical Expertise

DTC needs to assist posts with the necessary technical expertise to conduct end-use checks that require on-site inspections of technical commodities. Although DTC requires very few technical on-site checks, our participation with DTC personnel in one such inspection revealed that technical expertise is key to ensuring that a check will have its intended impact.

In November 1998, DTC performed an on-site inspection of a joint U.S./Israeli missile program to verify the end use of eight items licensed through State's munitions process. DTC participated in this inspection because Embassy Tel Aviv did not believe it had the necessary expertise to inspect various chemicals and components related to the missile program. DTC did not agree that an in-depth inspection was needed because the items could be verified through document and serial number examination.

During the inspection, it was clear that DTC and embassy personnel lacked the technical knowledge about the items that were inspected. As a result, the inspection lacked credibility and would not deter potential diversions. The lack of technical expertise may have even produced the opposite effect because it illustrated how little the inspectors knew about the subject. Although some of the items had serial numbers that could be easily identified, it is unrealistic for someone to verify the authenticity of one of these components if they have never seen one before and don't understand its purpose.

DTC officials disagreed with the need to place more emphasis on the selection criteria for end use checks, and believe that the checks noted in OIG's report were valid and yielded valuable information. DTC officials also stated that they are not in a position to furnish posts with specialized technical expertise.

Training for Licensing Officers

State does not have a formal training program for either munitions or dual-use license processing. For dual-use applications, we found no significant problems related to training or guidance. State's role is advisory in nature, and the officials responsible for reviewing licenses have extensive backgrounds in export licensing. The absence of training on the munitions side is

potentially more significant because DTC licensing officers have greater responsibility and make the final decision to approve a license.

DTC relies primarily on an apprenticeship program to train new munitions licensing officers. This consists of about 4 to 6 months in which junior officers work closely with more experienced staff to learn the fundamentals of the munitions licensing process and develop skills in specific munitions commodities. This apprenticeship training results in officers who are recognized as experts by U.S. courts, where they often testify. However, given the high turnover rate, it is important that DTC develop new approaches to training. In FY 1998, DTC lost 25 percent of its experienced munitions licensing officers. It will take at least 3 years of on the job experience to fully train the replacements.

Training for more experienced licensing officers is limited. DTC tries to arrange for in-house briefings from other agencies and bureaus within State to keep licensing officers updated on intelligence issues. However, there is very little opportunity for the licensing officers to receive training outside the office.

DTC should improve training and enhance resource materials for licensing officers. This should include developing an in-house training program for new licensing officers, creating a handbook that provides an overview of the munitions licensing process, and updating the country handbook that summarizes basic foreign policy issues related to individual countries. Although DTC agrees that these recommendations are desirable, they stated that resources are inadequate to implement these changes.

Cumulative Effect of Technology Transfers

There is no straightforward, comprehensive evaluation of the cumulative effect of technology transfers resulting from the export of munitions items. Information on the cumulative effect of individual munitions license applications is obtained from a variety of processes. However, DTC indirectly assesses this area of export licensing through: (1) licensing officer review of each application to establish whether the items are in the military inventory of the intended recipient, (2) the referral process, (3) managerial review of countries of concern, and (4) trend analyses.

Nevertheless, DTC represents only part of a much larger picture. To fully evaluate the cumulative effect of an application, other factors, such as the impact of foreign military sales, knowledge of what other countries are exporting, and the internal capabilities of a specific country would need to be evaluated. A comprehensive assessment would probably require a joint effort with resources and coordination from all Federal agencies involved in the licensing process. In addition, as stated in the interagency report, such an effort would probably require congressional direction.

Inadequate Resources

Inadequate resources have made it increasingly difficult for DTC to meet its mandate, which has broadened over the last 2 years. This has caused numerous problems within DTC including increased workloads for licensing officers and substantial delays in the license review

process. Since the 1993 joint OIG review, DTC's average processing time for nonreferred munitions applications has more than quadrupled, and the processing time for referred cases has more than doubled. The increased workload for licensing officers has also contributed to employee turnover as more senior staff accept higher graded and less demanding positions at other agencies and in private industry. State gave DTC an increase of \$2 million as of June 7, 1999. DTC plans to use the funds to add 23 new positions to its staff.

Increased Workload and Processing Times

During FY 1998, 16 licensing officers processed over 44,000 munitions licenses. In contrast, during the 1993 joint review, there were 22 licensing officers responsible for processing approximately 49,500 munitions licenses. This represents a 22 percent increase in the licensing officers' workload. Although the total volume of licenses has decreased, the number of more complicated, labor intensive cases have increased significantly. For example, technical and manufacturing agreements have increased by 88 percent, from 1,739 in 1992 to 3,278 in 1998. In addition, congressional notification cases have more than tripled since 1992 from 40 to 150.

The increased workload for licensing officers has resulted in longer processing times for cases. The average processing time for nonreferred and referred cases were as follows for 1992 and 1998:

License Processing Time at DTC

Fiscal Year	Average Processing Time for NONREFERRED cases	Average Processing Time for REFERRED cases
1992	4.5 days	38 days
1998	21 days	86 days

The increased processing time negatively affects U.S. businesses, which are forced to wait longer for licenses. The longer processing times also increases the licensing officers' workloads because they receive additional inquiries from exporters regarding the status of a license.

DTC Staffing

In comparison to the other agencies involved in the export licensing process, DTC has fewer staff and lower pay grades. For example, DTC has the lowest journeyman grade level, yet it has the highest workload in the export licensing community. This impedes DTC from maintaining an experienced staff and is problematic because it typically takes about 3 years before a licensing officer is familiar with most aspects of the job. The following table presents a comparison of the workload and grade levels of the agencies involved in the export licensing process:

Workload of Export Licensing Agencies

Agency	# of Applications Received in FY98	# of Licensing or Reviewing Officials	Ratio of Licensing Officials to Licenses	Journeyman Grade Level of Licensing Officials
State (DTC)	44,212	16	1:2,763	GS-13
Commerce (BXA)	13,541 ¹	47	1:288	GS-14
Defense (DTRA)	11,053	9	1:1,228	GS-14 and 15

Lower grade levels and increased workloads impede DTC from attracting and retaining personnel. In recent years, two of DTC's more senior licensing officers accepted GS-14 promotions at Defense. Licensing officers have also accepted higher graded positions in other bureaus within State. DTC management expects additional turnover because Defense and another office within the PM bureau currently have openings for higher graded licensing officials. Our review recommended that State develop a plan to rationalize the grade structure of licensing officers with other agencies involved in the export licensing process.

Commercial Satellite Launch Responsibility

DTC's difficulty in addressing its workload with current staffing levels will be magnified by a provision in the National Defense Authorization Act for FY 1999, which transferred the licensing of commercial satellite launches from Commerce to State. Not only will this increase the total volume of licenses that DTC must review, it will also require DTC to provide additional reporting to Congress.

Department Comments on OIG Recommendations

Our report contained 13 recommendations for improvements that we believe are needed in State's export licensing operations. State officials generally agreed with 11 recommendations, including those to strengthen supervisory review, expand training, improve database accuracy, and provide referral decisions to other agencies. They did not agree with two recommendations in our report pertaining to the selection criteria for end use checks, and furnishing posts with specialized technical expertise for such checks.

* * * *

This concludes my statement Mr. Chairman. I would be happy to answer any of your questions.

¹ This figure includes approximately 2,573 commodity classification requests. Each commodity classification request can include up to 5 line items. Exporters submit commodity classification requests to Commerce, which determines whether the commodities require a license or not.