



United States Department of State

Washington, D.C. 20520

SEP 10 2007

Case No.: 200605280

Mr. Matt Schroeder
Manager, Arms Sales Monitoring Project
Federation of American Scientists
1717 K Street, NW - #209
Washington, DC 20026

Dear Mr. Schroeder:

In response to your request dated October 13 2006 under the Freedom of Information Act (Title 5 USC Section 552), we conducted a search of our Bureau of Political-Military Affairs and retrieved two documents responsive to your request.

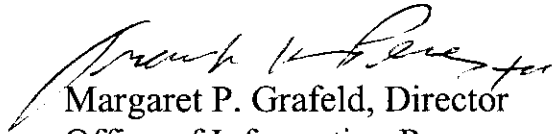
After reviewing these documents, we have determined that both may be released in full. All released material is enclosed

The Freedom of Information Act provides for the recovery of the direct costs of searching for and duplicating records requested for non-commercial use. However, no fee is charged for the first two hours of search time or for the first one hundred pages of duplication or if the cost of collecting and processing the fee exceeds the amount of the fee. Since billable costs in this case do not exceed \$10.00, your request has been processed without charge to you.

We have now completed the processing of your case. If you have any questions, you may write to the Office of Information Programs and Services, SA-2, Department of State, Washington, DC 20522-8100, or telephone us at (202) 261-8484. Please be sure to refer to the case number shown above in all correspondence about this case.

We hope that the Department has been of service to you in this matter.

Sincerely,

A handwritten signature in black ink, appearing to read "Margaret P. Grafeld".

Margaret P. Grafeld, Director
Office of Information Programs and Services

Enclosures:
As stated.

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REPORT TO CONGRESS
ON DEFENSE TRADE LICENSING

RELEASED IN FULL

Requirement and Scope

The Conference Report (H. Rpt. 109-272) accompanying the Science, State, Justice, Commerce and Related Agencies Appropriations Act, 2006, (P.L. 109-108) incorporates by reference a provision from the House Report (H. Rpt. 109-118), which "directs the State Department, in consultation with the Commerce Department, to provide a plan within 90 days of enactment of this Act to help effectuate a more timely and accurate export licensing process." As the report language is directed to the State Department, the scope of this report will be limited to defense trade controls, which are under the licensing jurisdiction of the Department of State. Moreover, as the Congress' direction is focused on the "export licensing process," this report does not deal with government-to-government arms transfers (e.g., sales under the Foreign Military Sales program), which require the approval of the Department of State but do not require a license. This report has been coordinated with the Departments of Commerce and Defense.

Background

The regulation of defense trade is a complex activity involving many activities in addition to licensing, including the following:

- policy development to further foreign policy and national security interests, including the implementation of arms embargoes and U.S. efforts to persuade the European Union not to lift its arms embargo on China;
- updating the U.S. Munitions List (USML) and determining whether specific products are appropriately controlled under the USML;
- records management and information technology development;
- registration of U.S. persons and review of foreign parties involved in defense trade (including brokers);
- ensuring compliance with U.S. laws and regulations; including cooperation with law enforcement agencies.

An attachment to this report provides background on the overall defense trade control process.

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The primary mission of defense trade licensing, and the reason the Department of State has been responsible for the regulation of defense trade since 1935, is to ensure that U.S. defense exports support the foreign policy and national security objectives of the United States. The most important of these objectives are the following:

1. To ensure that U.S. defense technology is kept out of the hands of governments and groups, including terrorists, that may do us harm. With few exceptions authorized by U.S. law and regulation, all exports of U.S. defense articles or services require case-by-case review and approval by the State Department, often in coordination with the Department of Defense and other government agencies. All parties to an export authorization are checked against a Watchlist of more than 120,000 suspect parties. No retransfer or change of end use is authorized without the prior written approval of the Department of State. More than 500 "Blue Lantern" checks by U.S. diplomatic missions each year inform the licensing process by determining the *bona fides* of foreign parties to an export and establishing whether previously exported U.S. defense items have been retransferred without authorization. As a result, the U.S. defense trade control system, which is without parallel among major arms exporting countries, has been singularly successful in keeping U.S. defense items out of the hands of our antagonists, including terrorist groups.
2. To ensure that U.S. friends and allies have access to the U.S. defense equipment and technology they need to make their military forces more effective and capable of operating jointly with the United States against common enemies. In FY 2005, the State Department approved licenses and other export authorizations worth \$52 billion, the vast majority of which were for established U.S. friends, allies and Coalition partners in the Global War on Terrorism. The top priority of all licensing officers is an expedited licensing program for Coalition partners in Operations Enduring Freedom and Iraqi Freedom, which in FY 2005 included 768 licenses with a median review time of seven calendar days. Another priority program is for exports to the United Kingdom and Australia, which Congress mandated by law in 2004 in lieu of approving limited licensing waivers for the UK and Australian governments and companies in those countries that the United States would select. In FY 2005, the

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State Department also authorized 278 technical assistance agreements (worth \$1.4 billion) for the eight international partners in the Joint Strike Fighter program with a median review time of 35 days.

Matching Resources and Requirements

Defense trade licensing has become much more complex in recent years as a consequence of the increasing globalization of the defense industry and the growing importance of exports of technology (defense services) – which now account for about half the value of authorized U.S. defense exports (\$28 billion in FY05).

The most important challenge to the licensing process, however, has been the sheer growth in volume of applications for licenses and agreements. The 65,000 applications received in FY 2005 marked the third straight year of roughly 8% annual increases in licensing volume (FY 2004: 60,000, FY 2003: 56,000). Although an 8% increase in workload equates to a requirement for three additional licensing officers per year, there has been no increase in licensing officers during this period. Indeed, because of the military's pressing personnel requirements for the Global War on Terrorism, there has been a major problem in obtaining backfills for the eight military officers on detail to the Directorate of Defense Trade Controls (required by Sec. 38(g)(8) of the Arms Export Control Act); one of these military positions has been gapped for more than 20 months, with no prospect of a replacement until summer 2006. When added to the time-consuming process for filling Civil Service vacancies (currently three licensing officer vacancies), the number of licensing and agreements officers with signature authority is actually fewer than at this date the last year.

Predictably, the increase in licensing volume without a corresponding increase in trained and experienced personnel has resulted in delays. Although median review times for FY 2005 were roughly comparable to the figures for FY 2004 (14 days for the roughly 70% of cases that are handled within Directorate of Defense Trade Controls, and 51 days for cases staffed to other parts of the State Department and/or DOD), by the end of the calendar year median review times had increased to 20 days for cases not staffed to other agencies and 61 days for staffed cases in December 2005. It is apparent that overall licensing times are increasing.

Recent, Current and Imminent Measures to Reduce Licensing Times

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1. The most important measure to address the timeliness issue in defense trade licensing is the Defense Trade Application System (DTAS), a fully electronic licensing, compliance and records management system. D-Trade, the licensing component of DTAS, was inaugurated in 2004 and is being improved and expanded. The quality control function of D-Trade greatly reduces the number of flawed license applications, and fully electronic submission, referral and issuance reduces document handling times. In FY 2005, the median review time for D-Trade license applications was half that of the paper-based legacy system (19 days vice 38 days, both staffed and unstaffed). Currently, about one-sixth of all license applications are being submitted via D-Trade, and this proportion is expected to increase as industry becomes more comfortable with the fully electronic system and additional types of license applications can be submitted via D-Trade. (Currently, D-Trade can only process permanent unclassified exports of defense articles.) If the development of D-Trade proceeds as planned, the State Department plans to require all license and agreement applications to be submitted by D-Trade by early in calendar year 2007. It should be noted that the timeliness savings provided by the electronic process do not reduce the time required for substantive review of cases by officers at State or Defense.
2. Since 1935, companies engaged in defense trade have been required to register with the State Department and pay an annual fee, which Congress has allowed the State Department to retain for some defense trade control purposes. In 2004, the State Department increased the registration fee from \$600 to \$1,750 per year. The retained funds have made it possible to hire more contract employees to assist in defense trade licensing and compliance activities and to help support D-Trade development. However, legislation currently restricts the uses of the retained fees, which cannot be used, *inter alia*, to purchase FTE or pay for contractors to assist in the preparation and clearance of commodity jurisdiction determinations (i.e., decisions on whether specific products are controlled under the US Munitions List or the Commerce Control List).
3. In October 2002, President Bush tasked Executive Branch agencies with a review of the defense trade control process. The review

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produced 17 policy and process recommendations, which were briefed to Congressional staff in May-June 2004. A decision whether to implement any or all of these recommendations is pending.

Where Congress Can Help

Congress has an important oversight role regarding arms transfers, reflected in the Arms Export Control Act (AECA) and the Foreign Assistance Act (FAA) of 1961. However, there are a number of steps that Congress could take that would help expedite the licensing process without a significant reduction in that oversight role.

1. Relief from Congressional Reporting Requirements: The preparation of the report on export authorizations from the previous calendar year (required by Sec. 655 of the FAA) and the Javits report on arms transfers that might be authorized in the coming year (required by Sec. 25 of the AECA) consumes thousands of man-hours on the part of industry and the Departments of State and Defense. The value or benefit of this report to Congress is not obvious. The opportunity cost associated with preparing these annual reports is significant, and eliminating these reporting requirements would free up substantial manpower for licensing and other defense trade activities.

2. Raising the Thresholds for Congressional Notification of Arms Transfers: Sec. 36 of the AECA sets the thresholds that require prior notification of arms transfers (government-to-government as well as licensed) before the transfers may be authorized. These monetary values have not kept pace with the increasing cost of defense equipment over the years. The notification periods (15 days for NATO, Japan, Australia and New Zealand, 30 days for other countries) and the pre-notification consultations (see next item) substantially delay the approval of about 200 major arms transfers every year. Following are the current notification thresholds, with recommended (higher) values in parentheses:

	<u>NATO, Japan, Australia, NZ</u>	<u>Other Countries</u>
Major Defense Eqpt	\$25 m (\$100 m)	\$14 m (\$25 m)
Other Defense Items	\$100 m (\$200 m)	\$50 m (\$100 m)

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In addition, Sec. 36 of the AECA requires the notification of all firearms transfers over \$1 million and all overseas manufacturing agreements for Significant Military Equipment (SME), regardless of value. It would be reasonable to adjust or establish these notification requirements to the applicable threshold for other arms transfer approvals.

3. Eliminate At Least Some Pre-Notification Clearances: While not required by law, the Executive Branch engages in pre-notification consultations with Congressional staff prior to formal notification of arms transfers. With rare exceptions, arms transfers are not notified until Congressional staff from both political parties in both chambers have given their clearance. Unlike the formal notifications required by Sec. 36, there is no time limit on the pre-clearance process, which can last several months. In some cases, this provides an opportunity to address Congressional concerns on foreign policy issues associated with the proposed transfer, but in many cases no substantive issues are raised by Congressional staff. In 2005, 57 days (on average) were spent in pre-consultations on Sec. 36 cases, about twice the maximum time required under the formal notification process. The longest was 245 days. Congress could greatly contribute to the timeliness of arms transfers (both licensed and government-to-government) if this non-mandatory pre-notification process could be eliminated (allowing the Executive Branch to proceed directly to formal notifications) in some or all cases.
4. Remove Restrictions on Use of Retained Registration Fees: As noted above, the State Department is currently restricted from using registration fees for any defense trade activities other than those directly related to licensing, compliance and IT modernization. Removing these restrictions would allow the funds to be used to purchase FTE and to hire contractors to assist the State Department in the preparation of commodity jurisdiction determinations.
5. Electronic Submission of Congressional Notifications: Congressional agreement to accept Sec. 36 notifications electronically instead of in paper form would expedite the process. The technology exists to ensure electronic signature authenticity.

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