

# THE EXPORT ADMINISTRATION ACT: A REVIEW OF OUTSTANDING POLICY CONSIDERATIONS

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## HEARING

BEFORE THE

SUBCOMMITTEE ON TERRORISM,  
NONPROLIFERATION AND TRADE

OF THE

COMMITTEE ON FOREIGN AFFAIRS

HOUSE OF REPRESENTATIVES

ONE HUNDRED ELEVENTH CONGRESS

FIRST SESSION

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# THE EXPORT ADMINISTRATION ACT: A REVIEW OF OUTSTANDING POLICY CONSIDERATIONS

THURSDAY, JULY 9, 2009

HOUSE OF REPRESENTATIVES,  
SUBCOMMITTEE ON TERRORISM,  
NONPROLIFERATION AND TRADE,  
COMMITTEE ON FOREIGN AFFAIRS,  
*Washington, DC.*

The subcommittee met, pursuant to notice, at 10:06 a.m. in room 2172, Rayburn House Office Building, Hon. Brad J. Sherman (chairman of the subcommittee) presiding.

Mr. SHERMAN. We will bring the subcommittee to order. I would like to thank the witnesses for being here, at least two of them.

I know that Governor Engler is on his way. I am sure his staff, who is here, will tell him that this opening statement by the chairman was erudite, concise, truly an inspiration.

The purpose of this hearing is to examine how the U.S. Government can implement necessary safeguards to protect national security and simultaneously preserve American jobs in industries that are subject to export control. We must make the current system more effective to reflect economic realities. National security is the paramount concern.

This hearing will hopefully provide the first step in a long overdue process to reauthorize the Export Administration Act, also known as the EAA.

The Export Administration Act provided statutory authority for export controls on sensitive dual-use technologies, namely those technologies that have both a military and a civilian use. It expired 8 years ago, demonstrating that it is by no means clear that the United States Government needs a Congress since for 8 years we haven't had the law and things have gone on pretty much as they were before.

Despite several attempts earlier this decade, Congress has not been able to reauthorize the Export Administration Act since it expired in 2001. Instead, our control over dual-use goods has been imposed for nearly a decade by regulatory fiat under the International Emergency Economic Powers Act.

One problem that arises from this, however, is that the Commerce Department, the agency responsible for enforcing our dual-use export control regulations, and particularly the Bureau of Industry and Security, the BIS, lost its status as a law enforcement

agency and therefore lost powers that it needs to carry out its job most effectively.

Representative Manzullo and I have introduced the Export Control Improvements Act. We did this last year. We will be reintroducing it this year. We look for additional co-sponsors.

The bill addressed a handful of issues related to the EAA, including the integration of export control data into the automated export system, which is a system basically currently maintained for statistical purposes. It reinstated the BIS' law enforcement authorities and dealt with diversion and transshipment of goods.

Now, recently the GAO released a study on June 4 that demonstrated the obvious, but did so poignantly. It described how undercover investigators successfully purchased dual-use sensitive items from distributors and manufacturers using a bogus front company, fictitious identities and a domestic mailbox.

They were also able to ship without detection by U.S. enforcement officials dummy versions of the items subject to export controls to known transshipment points for terrorist organizations and foreign governments who are hostile to the United States and attempting to acquire sensitive technology.

More specifically, they obtained what are known as spark gap plugs, not to be confused with spark plugs or spark plug gapper. A spark gap plug is a device that can be used in either highly technical medical equipment or can be used in a nuclear device. It has a limited number of legitimate domestic users. It is of great economic importance.

What this study demonstrated was what I think we already know, and that is if any one of 300 million people can buy it easily it is kind of silly to say that we are going to license its export, especially if it is a relatively small, non-bulky item.

We can go through the charade and give ourselves the psychological joy of saying we are controlling sensitive technologies, but if anyone who happens to be a tourist in the United States, anyone who happens to be in the United States, any diplomat who happens to be in the United States can just desktop publish some stationery and rent a P.O. box and obtain a spark gap plug then it is going to be silly to say oh, we are going to prevent that from being exported.

Maybe  $\frac{1}{10}$  of 1 percent of the export packages are looked at by U.S. Government authorities, so maybe if you wanted to export 1,000 spark gap plugs you would have to buy 1,001, mail them all and figure you are going to lose one to the inspection process.

There is no requirement when somebody is sending something abroad that they use a legitimate sender address on the package, so there is no risk of liability. You do risk maybe one-thousandth of your shipment.

So we ought to be looking at a different approach to controlling items, particularly those items that are small and available to just about anybody in the United States. We ought to categorize items on a number of different formats. The first is the item freely available in the United States or is it, like some chemicals, subject to a licensing procedure?

Second is size. How bulky is the item in a quantity of great significance to our adversaries? Obviously a bullet is small, but if you

want to drive us out of Afghanistan you need a number of bullets that I would describe as quite bulky.

Does the item have a legitimate civilian use? We saw orange patches designed to be used by U.S. soldiers to prevent our aircraft from shooting at them appear on the dress of Taliban. Why? Apparently because anybody in the United States can buy these orange patches designed for this exclusive military use. They have no legitimate civilian use. Once anybody in the United States can buy it, it is not surprising that the Taliban can get their hands on it.

We have to look at whether allowing the export is good for American jobs or is in fact a job killer. We have circumstances where the entire purpose of the export is to ship something overseas, have it processed and have it returned to the United States. In other words, what looks like an export regulation that is hurting jobs may actually be preventing the offshoring of jobs.

We should not think of sacrificing one iota of our national security in order to facilitate offshoring and job killing, and we ought to of course, as we do now, look at whether the item is widely available abroad without significant controls.

Now, to control these items effectively may involve the jurisdiction of other committees, but I don't want to go back to my constituents and say we don't have an effective export control program. We do have a program that is killing a lot of jobs for no good reason, but don't worry about it. At least we didn't involve any of the other committees in Congress.

It seems to me that we are going to need to decontrol some items and we are going to need to have control at the factory gate for other items. There is no reason why anybody in this country can buy a spark gap plug.

So I look forward to taking a fresh look at our export controls, looking at national security, looking at the effect on American jobs, looking at what is really practical and perhaps creating a circumstance where we control a lot less and we control it a lot better.

I now yield to our ranking member, the gentleman from California.

Mr. ROYCE. Thank you, Mr. Chairman. I thank you also, Brad, for holding this committee hearing today, and I think it continues the subcommittee's work on this critical and rather arcane issue of export controls.

Our satellite export hearing that we had in April I think produced some important language for the State Department authorization bill, and previous hearings that we have had spurred some greater efficiencies in terms of export licensing. It is clear to me, however, that more fundamental changes are needed here.

An effective export control system does a couple of things. It denies sensitive technologies to foes, including Iran and terrorist organizations. It has to have the capacity to match sophisticated proliferation networks such as A.Q. Khan's network. At the same time, effective controls have got to facilitate technology exports to all others.

Our national defense relies upon a technological edge. Having an edge in the face of increasing global competition requires vibrant manufacturers who depend upon robust exports and cooperation with governments and companies overseas.

Unfortunately, our export control system is a bureaucracy, while our enemies, agile and determined and bold, are not. The system has trouble making decisions and focusing on the really important items and leaving the others alone.

Two years ago, the subcommittee heard from the Government Accounting Office, and the GAO reported poor coordination between the State and Commerce Departments. Problem number one. Problematic disputes over which export control lists particular items belong on, and that problem continues. These factors harm investigation and enforcement activity, and there is a lack of systemic assessments which create, in their words, significant vulnerabilities.

The GAO had designated the effective protection of technology critical to national security as "a high risk area." Some progress has been made, but the high risk label in their assessment remains.

The lack of a valid EAA statute is a problem. Dual-use items are regulated through a patchwork of emergency authorities and executive orders, complicating prosecutions. There are other legal shortcomings that make it difficult to target commercial espionage, and commercial espionage has become a growing problem in this area.

I am concerned with the Validated End User program run by the Commerce Department. One of today's witnesses has documented the problems of tracking sensitive exports to China.

Last year the GAO recommended that this program with China be suspended because the Department had not been able to reach an agreement with Beijing for on-site reviews. There is an agreement today, but knowing what I know about China, where the industrial/military line is blurred, to say the least, this provides small comfort.

Mr. Chairman, the subcommittee must keep pushing, but without strong leadership and commitment from the highest levels of the current administration we are carrying an awfully heavy load. Unfortunately, I don't see that type of commitment happening, and this is not being partisan. The previous administration was no different. These issues aren't attention-grabbers until I suppose there is a glaring failure.

Hopefully I am wrong, but let us keep harping on this issue, doing our job, holding these hearings and trying to drive legislation to improve this process. I thank you again for holding this hearing.

Mr. SHERMAN. I thank our ranking member. I know he will have to go back to Financial Services for a brief time. We look forward to seeing him again.

Are there any other members who wish to make an opening statement? I believe our vice chair has an opening statement.

Mr. SCOTT. Thank you, Mr. Chairman. Monitoring and controlling the items we export that may pose a national security risk is undoubtedly a high priority for me, this committee and this Congress.

And certainly no one wants to see dual-use items fall into the wrong hands and be turned against the United States either by terrorists or rogue governments, and that includes the United States companies that make and market this technology.



However, we must keep in mind the need for our companies to be able to stay competitive in an increasingly integrated global marketplace. Globalization is no longer just an emerging phenomenon. Globalization is now our way of life. We are no longer the sole supplier for a great many of the items that we control the export of, and that list is growing quickly.

Moreover, there are many countries with less stringent and less complicated export control systems that afford their companies greater opportunities to compete. We saw that in our examination of satellite technology exports several months ago.

So we must find the proper balance between protecting sensitive materials and allowing our companies to contend, and I think perhaps developing a broader, more robust Validated End User program can very well allow us to do just that, so I am interested in hearing our witnesses and their thoughts on expanding that program.

Mr. Chairman, I am also very concerned, as I know that you are as well, by an article that I recently read in the Washington Times, this article in the Washington Times regarding the domestic availability and subsequent diversion of sensitive technologies.

The article highlights a recent GAO investigation into procurement of dual-use and military technology over the internet and the case of sending that equipment to persons and places that would ordinarily require an export license. With the blossoming of the internet and the person-to-person commerce it has facilitated in the modern world, I think an examination into the possibility of controlling some of this diversion is absolutely warranted.

With that, Mr. Chairman, I will join you in welcoming our witnesses, and I yield back the balance of my time.

Mr. SHERMAN. I thank the gentleman from Georgia and yield to the gentleman from California.

Mr. ROHRABACHER. Mr. Chairman, first and foremost I would like to thank you for the personal interest you have taken in this issue. Your leadership on this issue of looking at exports and the export controls that we have to deal with in our society is going to be of great service to the people of this country, so I want to especially let you know that we appreciate your focus on this very important subject.

Being an accountant—I am a former journalist, and most of the people we work with are former lawyers. Brad is a former accountant, and he knows when something doesn't add up, something doesn't look right with the figures. Certainly when you take a look at export controls, Mr. Chairman, it doesn't add up. It does not. The cost and the effectiveness do not just correlate the way they should in terms of government regulations.

I personally believe in free trade between free people, and I have always advocated that. Over the years there has been a great difficulty in trying to promote even free trade between free people because what has happened is there have been certain people and groups in our society that are making so much money in dealing with despotic and hostile governments and hostile societies that we have had to try to have the same restrictions placed on them, yes, but also those same restrictions placed on people who are actually

trading with free countries, with Belgium, with Brazil, with Britain, with Italy.

It makes no sense at all that we should be controlling the trade with free peoples throughout the world because we are unwilling to set a two-track system in place that will help us regulate and control those technologies that go to despotic and potentially hostile regimes as separate from those countries that are run by democratic governments and that pose no threat to the United States of America.

The last hearing we had on this issue highlighted that when we talked about China and the transfer of technology that went to China about 15 years ago when we were permitting Chinese rockets to be launching American satellites, and then in the end what happened was we upgraded their entire rocket and missile system in China.

But because high tech industry in this country has been so intent on making a very quick profit from the China trade that we have been unable to free other companies that would like to have long-term economic relationships with freer and more democratic countries from the restrictions that we have to place on Commerce because of these other companies who want to focus their profit making on dictatorships and potentially hostile countries.

This is an issue that cries out for some serious consideration. Again, I think the answer in the long run is for us to be honest about what countries pose a threat, what groups pose a threat there, to see that our technology doesn't go to those people that will come back and hurt us, but at the same time commit ourselves to freeing up the trade between countries and people that pose no threat to us.

So in short a two-tier system, which we have not been able to implement in the past, is something that would serve us well. Thank you very much, Mr. Chairman.

Mr. SHERMAN. And we will yield to the gentleman from New York for an opening statement.

Mr. MCMAHON. Thank you, Mr. Chairman, and I echo the sentiments of our colleagues and commend you for convening this very important hearing.

Clearly export controls serve an incredibly valuable purpose, yet at the same time the economic future of our country depends on our ability to compete on a global market.

The world would be a far more frightening place if a country like Iran acquired and developed nuclear, biological or chemical technologies through the seemingly innocent transfer of technology. Unfortunately, this example was illustrated in 2006 when the computer circuits exported to the UAE were diverted to Iran, where they were fashioned into bomb detonators and used in Iraq.

History has proven that hostile regimes have managed to penetrate U.S. export controls network due to the fact that the international community has yet to follow suit with similar export controls of their own.

There is no doubt that the United States still has the most sophisticated defense technologies in the world, which is the reason why we must guard our designs through such extreme—which seems sometimes to be extreme—restrictions. But these limitations

are no doubt decreasing the prestige and need for our technologies in the world.

There is a great need to balance nonproliferation standards with the U.S. competitiveness in the global market. I am particularly concerned with restrictions on commercial communications satellites and gray areas in the Export Administration Act which deal with encryption technologies used in free global communications and messaging technologies.

In regards to satellites, I am concerned that if other countries, our allies even, were to develop ITAR free satellites and become as competitive in the United States in this market we would most certainly reach a whole new frontier in global terrorism.

And although I do not share the same concern for encryption technologies, it is important to note that foreign regimes cannot use messaging services for nefarious purposes; rather the civilians living under these regimes can access and relay more information to the outside world through the use of these technologies as we have seen in the recent Iranian election protests.

Therefore, I would like to learn from our distinguished panel of witnesses today how the U.S. can successfully balance its business interests with the security interests of not only the United States, but the whole world.

Again, thank you, Mr. Chairman, and I yield the remainder of my time.

Mr. SHERMAN. I thank the gentleman from New York.

We will now move on to our first witness. We welcome the former Governor of Michigan, John Engler, who currently serves as president and CEO of the National Association of Manufacturers.

Mr. Engler?

**STATEMENT OF THE HONORABLE JOHN ENGLER, PRESIDENT AND CHIEF EXECUTIVE OFFICER, NATIONAL ASSOCIATION OF MANUFACTURERS (FORMER GOVERNOR OF THE STATE OF MICHIGAN)**

Mr. ENGLER. Thank you very much, Mr. Chairman and Ranking Member Royce, who will be back I am sure, members of the subcommittee, fathers of triplets. We have that in common.

The National Association of Manufacturers appreciates very much today's hearing on the Export Administration Act, the EAA. I have prepared a statement for the record that is more extensive, and I just want to offer some brief initial remarks.

While it is not often in the public eye in recent years, certainly the issue of export controls is one that truly ranks as a priority. It is a competitive priority for the nation and for our Nation's manufacturers.

Commerce Secretary Gary Locke recently met with members of the NAM Executive Committee, and it was interesting in our discussion, which was wide-ranging. Several times we came back to the topic of export controls. It is that important. Export controls exist to protect our national security, and that must always be paramount, but when export control policy becomes obsolete, national and economic security are both threatened and American jobs are lost.

Obsolete export control policies that control too much promote the growth of technologies in other countries and other parts of the world. These are areas where we compete, and when we promote the growth of technologies there it comes at the expense of U.S. jobs.

The NAM and the Coalition for Security and Competitiveness believe in the need to modernize the export control system. Modernization would improve both our security and our competitiveness.

The current export control system was developed really 60 years ago at the onset of the Cold War. The last time the EAA was actually updated by Congress was in 1979, three decades ago, and the threat that the system was designed to address at the time, the Soviet Union, actually doesn't even exist in that form any longer.

Today the threats are different, and some of them have been I think eloquently described by the committee members today, but yet the export control system hasn't really changed to deal with them effectively. When the current system was developed, the United States was the source of almost all the cutting edge technologies and could unilaterally deny foreign access to them.

The United States remains a leader in technology, but many other nations have developed equally good or in some cases even better technologies. The bottom line is that key technologies are often available globally, and buyers have alternatives.

I think the chair and Congressman Scott, you both made this point in your opening comments. The question of foreign availability rarely came up when the export control system was first developed, and now it is one of the dominant facts of global commerce.

These trends—wider availability, greater competition—will only accelerate. Restricting United States sales of products being freely sold by Germany or Japan or Italy, other countries, does nothing to help United States national security. However, it does harm our Nation's economic strength, and I think it harms very much our future innovation.

Our economy depends on our ability to compete globally in high tech areas, as Congressman Rohrabacher mentioned, and we compete not on labor costs, but on quality and the ability to innovate and the ability to develop new technologies. We must seek to be number one in technology and innovation.

Today our share of the world's manufactured goods exports is less than 10 percent. It is about half of what it was 25 years ago. Employment in America's high tech industries is almost one-fourth smaller than in 2000, and high tech exports now account for less than one-third of all our manufactured goods exports. That was about 40 percent in 2001. Our export controls are a contributing factor to this decline.

The NAM and the CSC have been working with the administration to obtain changes that lessen the burden on American manufacturers without putting national security at risk. We have made 19 proposals. Most of them were adopted or accepted by the previous administration, and we are continuing to work for additional changes with the Obama administration.

All this helps. We cannot ignore that the need for change is so fundamental that a new twenty-first century Export Administration Act is necessary to design controls that will be effective in the twenty-first century that we live in.

My prepared statement lists the major principles the NAM believes the new EAA should be based on. We need a more focused, effective and efficient control system. Clear lines of agency jurisdiction and changes to licensing mechanisms are necessary. There should be regular reviews to update lists of what needs to be controlled and sunset provisions to ensure obsolete items drop off the lists.

Foreign availability and mass market status need to move to center stage in determining what is controlled. Intracompany transfers and steps to facilitate technology sharing with friends and allies need to be improved. Improvements are also needed to both the substance and enforcement provisions of EAA. Addressing one without the other does little to improve the system or to protect national security.

There are those, Mr. Chairman, who say well, modernism is some kind of euphemism for allowing companies to undercut national security. Absolutely not. We want strong security and strong controls on what is really sensitive. Changes we seek strengthen our security and focus government resources on the problem areas.

Mr. Chairman, I thank you very much. We hope to see a new EAA written this year. Our staff and I and our member companies would look forward to working with you.

[The prepared statement of Mr. Engler follows:]

**Testimony**  
**of the Honorable John Engler**  
*President and CEO*

*on behalf of* the National Association of Manufacturers

*before the* House Committee on Foreign Affairs, Subcommittee on  
Terrorism, Nonproliferation and Trade

U.S. House of Representatives

*Hearing on the* Export Administration Act: American Jobs and  
Security in the 21<sup>st</sup> Century

**July 9, 2009**

**Testimony of the Honorable John Engler  
President and CEO  
National Association of Manufacturers  
Washington, DC**

**Before the  
House Committee on Foreign Affairs  
Subcommittee on Terrorism, Nonproliferation and Trade**

**Hearing on  
“The Export Administration Act: American Jobs and Security in the 21<sup>st</sup> Century”**

**Thursday, July 9, 2009**

Mr. Chairman, members of the Subcommittee: I am John Engler, President of the National Association of Manufacturers (NAM). I want to thank you for holding this hearing on export controls and for offering me the opportunity to testify before you today. The NAM has worked with the Executive Branch to make improvements in the present system, and we will continue to do so. However, it is our belief that fundamental revision of the export control system is needed, and that can come only from a new and thoughtfully considered Export Administration Act (EAA).

NAM is the nation’s largest industrial trade association, representing small and large manufacturers in every industrial sector and in all 50 states. Our members play a critical role in protecting the security of the United States. Some are directly engaged in providing the technology and equipment that keep the U.S. military the best in the world. Others play a key support role, developing the advanced industrial technology, machinery and information systems necessary for our defense industries.

This hearing is an important part of the process of seeking what we hope will be a total revamping of U.S. export control policies and practices that will protect our national security without hampering the growth and competitiveness of American technology and manufacturing jobs. My statement will focus primarily on the importance of modernizing the Commerce Department system for export licensing and the impact that deficiencies in the current system have on manufacturers’ ability to support a strong national defense and build jobs in the high technology industries.

Two years ago the NAM joined with over two dozen other leading organizations to establish the Coalition for Security and Competitiveness (CSC) to seek the modernization of export controls. The present export control system is hampering our ability to innovate and to compete in world markets by maintaining too many policies and practices that are outmoded – and that contribute little to national security.

Over the past two years the NAM, working with the CSC, has promoted steps that lower the costs and inefficiencies of the existing export control system without impairing the level of security. These steps included developing 19 specific recommendations that the Administration could implement without legislative change to make the export control system more predictable, transparent and efficient.

Throughout 2007, I met with many high level administration officials including the top levels of the National Security Council and the Departments of Commerce, Defense, and State to advocate for changes that would simultaneously improve national security and economic competitiveness. Both the administration and the Hill complimented the NAM for putting forth balanced and practical recommendations to improve the system. As result, the President issued two National Security Presidential Directives (NSPDs), which represent the most substantial improvements to the system since the end of the cold war.

Although the 19 recommendations did not require legislation to enact, the NAM also engaged with the Congress to discuss the need for export control modernization and future legislative efforts. My staff and I met multiple times with the Chairman and Ranking Member of the House Foreign Affairs Committee as well as members of this Subcommittee, including you, Mr. Chairman, and Congressman Manzullo. We seek a new era of collaboration between the Hill, the Administration, and industry to develop a new export control system that works for the 21<sup>st</sup> century.

Since 2007, the increased attention by the NAM, the Administration, and this Subcommittee have led to many reforms, including the NSPDs and this Subcommittee's compromise with the State Department on the classification of civil aviation components (the so-called "17 (c)" issue) as well as legislation to improve license processing at the State Department. These are important improvements, but much more remains to be done to protect the national and economic security of the United States.

The degree of change needed is nothing short of a major revamping of the export control philosophy, policies, and implementation mechanisms. These changes cannot be made by the Administration within the present framework, and can only come from a new Export Administration Act (EAA). While the NAM appreciates the difficulties facing the Congress on this legislation, now is the time to develop a new EAA that will enact changes to bring the law into alignment with the current threats to our security, the realities of the global economy, and the interdependency between economic competitiveness, technological innovation and national security.



**Cold War Relic**

The current export control system was developed six decades ago to address threats our nation faced during the Cold War. The first export control act was passed in 1949, and renewed repeatedly with little change until the EAA of 1979, which attempted to bring the system into conformity with the realities of that period – though even that was 30 years ago. That legislation remains the basis of today’s export control system even though the Act has long since expired and the Administration is managing the export control system under the International Economic Emergency Powers Act (IEEPA).

While the export control system has remained essentially the same for 60 years, the threats to our security have not. The Soviet Union is gone, but our export control policies are still largely those designed for the Soviet threat. The United States faces new—and in many ways more complicated—threats to its security than in the past.

To address these evolving threats whether from terrorist groups, rogue states or other potential adversaries, we need an export control system that can keep genuinely sensitive technologies out of the hands of those who seek to harm us. This is critical for our national security, and U.S. industry supports that effort.

It is not only the security threat that has changed. Technology and the development of technological progress are fundamentally different from that for which the current export control system was designed many decades ago. Technology evolved slowly back then, but today it evolves at rates that frequently make high technology products obsolete in months.

Importantly, back then the United States dominated high-technology industries. Our export control system was – and to a large extent still is – based on the philosophy that if the United States won’t let countries have our technology, they can’t get it anywhere else because no one else has it. To a degree not recognized by our export control system, those days are gone. Now, while the United States is still a technological leader, it is but one of many. And in a growing range of technologies, other countries are leading the United States. It is not just Japan, Germany, France, and Britain that have among the best technologies today – increasingly South Korea, Taiwan, China, India and others are entering the field. The world has fundamentally changed. No longer is the United States the only country able to develop, design and manufacture cutting-edge technology. This is the reality of a globalized world and of the 21<sup>st</sup> century and these trends will accelerate.

Additionally, back then U.S. technology was developed almost exclusively in U.S. labs, and produced in U.S. factories. That is all changed in this new era of globalization. Today, the development of new technology and advanced products largely occurs through international collaboration, either through a network of company manufacturing and R&D facilities around the world or partnerships with foreign companies or research centers. As technological capabilities have increased abroad, the outdated control system has cost U.S. manufacturers global market share, lost sales and jobs – and has cut funds available to invest in developing the next cutting-edge technologies.

### **Changed Global Competition**

The economic future of the United States depends on our ability to compete in world markets. We are still the world's largest manufacturer, producing about one in every five dollars of all manufactured goods made globally. But our share of world exports of manufactured goods has been falling steadily, and we now account for only about 10 percent of world manufactured goods trade – half of what it was several decades ago.

We will never be the world's low-cost producer, and we have to compete on the basis of our technology, the quality of our products, and our marketing and distribution skills. The ability to innovate and to develop new technologies is absolutely key to our future. If we fail here, the decline of America as a world power, the decline in our ability to maintain the best military forces in the world, and the decline in our living standards will become inevitable. We simply must be the best in technology and innovation. We do not have a choice.

An efficient export control system that carefully focuses on truly sensitive and unique technologies without hampering other exports is essential to this objective as America competes in an increasingly crowded world market for high technology goods and services. But the present system restricts too many technologies, is costly, and creates delays and uncertainties for foreign customers. In fact, it is fairly common to see U.S. competitors advertising that their products are totally free of U.S. components and U.S. export controls. In this sense our export control system is a great export promotion program – for our competitors, not for us.

The current system is at odds with the way companies develop new cutting-edge technology today through international cooperation. U.S. companies collaborating on new technologies with their wholly-owned foreign subsidiaries may be required first to obtain an export license even to send an email, provide information over the telephone, or transfer a product across the Atlantic to its facility in another NATO country. These delays and uncertainties create a significant commercial disadvantage.

Competitors in Europe and Asia are designing out American products, components and technology due to the lack of transparency, efficiency and predictability in the current system. For example, one European company recently made a corporate decision to not allow *any* U.S.-made products in their systems because of the burdens of obtaining U.S. export licenses from the U.S. I have been told of instances in which customers in other countries have put provisions in their contracts that explicitly forbid the use of U.S. manufactured articles.

One of the principal concerns of U.S. industry is that the U.S. export control system does not effectively distinguish between items that are truly sensitive and those that are, in effect, commercial products widely available in the global marketplace. Control lists are out of date, and procedures to examine foreign availability are cumbersome and out of synch with what is widely produced and available from other countries. The question of foreign availability was a relatively ancillary one when the United States first started controlling exports, but today both foreign availability and the foreign capability to produce sophisticated technologies represent one of the dominant facts of global commerce. Restricting U.S. exports of products that others make (or could make, if they chose) and sell freely does not benefit U.S. security. Rather it only harms our economic strength and our ability to continue to develop technologies. This must be addressed as one of the core elements of any revision of the Export Administration Act.

High-technology industries play a vital role not only in defending our nation but also in promoting a strong and growing economy. Companies in this sector employ over 2.5 million workers, most of whom receive wages and benefits much higher than the national average. These are the sectors in which our future economic growth will come. Yet instead of seeing rising employment in these critical industries, jobs are falling. I find it shocking that employment in America's high tech industries is almost one-fourth smaller than in 2000.

We are going in the wrong direction, and insufficient growth in our exports is one of the most important reasons for this. In 2008, high-technology exports were \$370 billion – but this was less than one-third of our manufactured goods exports, compared to over 40 percent in 2001. This is not an acceptable trend for the future.

#### **Principles for a New Export Administration Act (EAA)**

As I noted at the beginning of my statement, the NAM believes that fundamental change is needed in U.S. export control policies and practices, and we believe this can be accomplished through thoughtful Congressional action on a new EAA.

The findings of numerous reports and statements from national security experts issued over the last few years all conclude that the current system is hindering, not enabling, the ability of the government to safeguard critical technologies and protect our national security. For example, the thorough National Academies of Science (NAS) report produced earlier this year clearly lays out the case that the current system is not producing the degree of security needed for today's threats and is harming our ability to compete economically.

All too often, national security experts and opponents to modernization seek to pit industry against national security interests, but in reality nothing could be further from the truth. Industry is not calling for the government to jeopardize national security, but rather to modernize a system that was created during the Cold War for a world vastly different than the current one, to assess which technologies are critical to national security, to ensure that the proper level of control is in place, and to improve multilateral cooperation with our allies. The NAM is committed to a sustained effort to modernize the export control system so that it is effective in preserving national security and our ability to compete globally.

As the Subcommittee begins to examine the provisions of a modernized system, I would like to highlight the NAM's key goals for a new export control system, which are to:

- Safeguard our national security through more effective and efficient control of sensitive exports. The system must identify and protect critical technologies in a reliable, transparent, and efficient manner. For example, as reflected in the NAS report, the list of controlled items should be narrowed to include only those items that are truly sensitive. Export control modernization will promote more effective deployment of government resources on higher-risk trade.
- Rationalize the export licensing system to reduce costs and processing times, ensure clear lines of agency jurisdiction, increase cooperation and efficiencies among the agencies involved in the process, and promote more responsive and efficient management of controlled exports.
- Institute systematic and regular reviews to update the export control lists and clarify definitions and interpretations so that those items and technologies that pose the greatest risk to national security and foreign policy are controlled and limited resources are focused on safeguarding these sensitive items.
- Create more efficient automated processes for determining what items and technologies are on control lists, applying for licenses, facilitating any necessary interagency reviews and securing export authorizations.
- Institute new licensing protocols to facilitate the transfer of controlled technologies and items between U.S. companies and their foreign partners and within companies' U.S. facilities so long as the companies maintain appropriate standards of internal controls and compliance.

- Strengthen U.S. security and enhance joint operations by facilitating defense trade and technological exchange with allies and trusted partners. Defense trade and advanced technology exchange with allies and friends build the interoperability, trust, and cutting-edge capabilities that are critical to keeping the nation secure, maintaining U.S. influence globally, and advancing our interests abroad.
- Revise the framework for program licensing by eliminating redundancies to facilitate technology-sharing with the nation's closest friends and allies, as these transfers are critical for the U.S. government's own national security programs.
- Improve industry-government cooperation by setting reasonable enforcement standards and practices for punishing bad actors while improving educational programs, outreach, and incentives to help companies that make good faith compliance efforts.
- Establish and apply a more meaningful standard minimizing U.S. controls on items readily available in the global marketplace, including consideration related to availability from foreign sources, the capability of foreign sources to produce an item, and the degree to which widely available items can actually be effectively controlled.
- Promote greater multilateral cooperation with our allies on export controls. Develop a more effective system of multilateral controls, minimize unilateral controls, and seek greater harmonization of export controls among major trading partners to both protect national security interests and level the international playing field for U.S. exporters.

#### **Specific Suggestions**

It is not my purpose to go into detailed recommendations at this point, and I hope the Subcommittee staff will be agreeable to holding some “roll-up-the-shirtsleeves” session to discuss some concepts with NAM staff and export control practitioners from NAM member companies that are heavily affected by export controls. I would, however, like to identify very briefly some of the key points, elaborating on the principles outlined above.

- ***Enhanced Authority for Licensing.*** The EAA should authorize and encourage the Bureau for Industry and Security (BIS) to implement licensing mechanisms that move away from the current transaction by transaction approach – particularly in intra-company transfers, while still ensuring control of sensitive items. Also, the EAA should encourage expansion of current general license authorities and create new ones for items controlled for other reasons than national security.

- **A New Licensing Mechanism for Deemed Exports.** The current Deemed Export regime should be replaced with a simplified new process that will both enhance national/homeland security and strengthen American's economic competitiveness.
- **Greater Assessment of Foreign Availability.** A better recognition of foreign availability must be a major pillar of any legislation to reauthorize the EAA, considering foreign availability from all countries -- not just from member countries of the international export control regime.
- **Mass Market.** Many technologies are so widely available legally today that U.S. unilateral controls and even existing multilateral controls have little or no ability to control such technologies. If legal mass market status is found, there should be a presumption not to control the item.
- **Encryption.** Many hardware and software products are increasingly being reclassified for export control purposes as "encryption items," due to the rapidly growing incorporation of encryption capability as a commodity feature in commercial hardware and software. These components are also increasingly incorporated into traditionally lower technology products. Publicly available encryption should not continue to be controlled in the current manner, which is creating administrative burdens and delays that can harm U.S. competitiveness and innovation. Major reforms are needed that: remove product review requirements for mass market and other commodity products and components; treat components as mass market items if they are designed for mass market products or are otherwise widely available; eliminate reporting requirements; and end unilateral encryption controls in general on publicly available encryption.
- **Systematic Review of the CCL and Implementation of a "Sunset" Standard.** While lifecycles for many new technologies are now as short as six months, many of the unilateral controls set by the government were implemented decades ago. There should be a "sunset" rule under which every item subject to a unilateral control on the Commerce Control List (CCL) will be taken off the list at a specified time unless a justification can be presented for maintaining the particular item on the list.
- **Review of Catch-all Controls.** Companies must now screen all exports for certain end-users and end-uses even though the items in question may be benign items such as pencils, refrigerators, and consumer goods readily available in almost any foreign market. Catch-all controls need to be focused on items of strategic value.
- **Creation of a Tiered Penalty Approach.** The EAA should authorize BIS to create a tiered penalty structure with self-disclosure being a mitigating factor.

While I understand the delicate nature of reauthorizing the EAA, I encourage the Subcommittee to avoid a piecemeal approach that only addresses changes in enforcement provisions. Both the substance and enforcement provisions are in need of fundamental reform and addressing one without the other will not fix the system. Changing the enforcement provisions of the EAA, while maintaining a broken system of controls, would still have the government enforcing a system that is not adequately designed to address the threats to our national security.

### **Conclusion**

If the United States is to maintain its technological leadership, EAA legislation must acknowledge that other countries can and do compete with the United States, and that many unilateral controls do not improve security but only undermine the ability of U.S. manufacturers to design the next generation of critical technologies. The NAM and our member companies fully acknowledge there are truly sensitive technologies that the United States must safeguard, but the broader policy should fully consider foreign availability, mass market status, and indigenous capabilities before unilateral controls are implemented. A healthy defense industrial base is vital for both our economic and national security. Indeed these are not two separate concepts; economic security is key pillar of, and a prerequisite for, our broader national security.

If careful consideration and study is not given to address national security and economic competitiveness, EAA reauthorization could worsen the current environment. If improperly reauthorized, the EAA could stifle U.S. exports, decrease U.S. competitiveness, and result in a precipitous decline in technological innovation—all of which would have serious negative repercussions for national security. If done correctly, though, the U.S. economy, American high-technology jobs, and national security will benefit significantly for years to come.

Thank you, Mr. Chairman.

Mr. SHERMAN. Governor, we thank you for your comments. I am going to have to interrupt you now because we do have a vote on the floor. We will resume this hearing immediately after the last vote in this series, which will probably be quite some time from now.

So I thank the witnesses for their patience, and we will be back as soon as we can be. Thank you.

Mr. ENGLER. We will be here.

[Recess.]

Mr. SHERMAN. I thank the witnesses for bearing with us for that short break, and I want to welcome Arthur Shulman, who serves as general counsel at the Wisconsin Project on Nuclear Arms Control, which carries out research and public education designed to inhibit the spread of weapons of mass destruction.

Mr. Shulman?

**STATEMENT OF ARTHUR SHULMAN, ESQ., SENIOR RESEARCH ASSOCIATE, THE WISCONSIN PROJECT ON NUCLEAR ARMS CONTROL**

Mr. SHULMAN. Thank you, Mr. Chairman. I am pleased to appear before you today to discuss dual-use export controls and their role in stemming the spread of mass destruction weapons. I will summarize a few points from my written testimony, which I ask be entered in the record.

The Export Administration Act is the foundation of our system for controlling the export of dual-use militarily sensitive technologies from the United States. While the EAA has been in lapse, the export control system has not been updated to reflect the post-Cold War and post-9/11 security environment.

But the focus on export control reforms should be on ensuring that the system protects U.S. national security in the twenty-first century. We need a comprehensive public analysis of the current security challenges, how the dual-use export control system is meeting these challenges and what changes are needed.

Thanks to the efforts of the subcommittee, our Nation's arms exports will be subjected to just such a comprehensive national security review if H.R. 2410 becomes law. The same must now be done for dual-use trade. Only then would we have the hard data needed for thinking about a new Export Administration Act, one that would protect our security today and tomorrow.

In the interim, we must ensure that the current system is working well to protect us. In many ways it is not, but there are things we can do now to change that. Congress should give the Bureau of Industry and Security at Commerce enough resources to do the job it has now. Congress should also provide robust oversight to ensure that those resources are being used well.

On export enforcement, we support your efforts to pass a stand-alone bill that would immediately give the Office of Export Enforcement at BIS permanent law enforcement authority. BIS must also get more staff and resources to do its export enforcement work.

I will cite two examples where BIS must do a better job administering controls. I discussed them in my testimony before this subcommittee last year and will provide a brief update. One is the 2-year-old Validated End User program (VEU). It is supposed to be



a white list of trusted companies and locations prescreened to receive controlled goods license free.

But my organization revealed last year that two of the first five Chinese companies designated as VEUs were closely linked to China's military/industrial complex, to Chinese proliferators sanctioned by the United States and to U.S. companies accused of export violations.

Another Chinese VEU was designated this April, and our analysis reveals that components useful in gas centrifuge enrichment plants can now be shipped without limits or prior scrutiny to a building that houses the headquarters of a Chinese company which as recently as December was under United States sanctions for proliferation to Iran and/or Syria.

I ask that this analysis be made part of the record for this hearing.

A month after this new Chinese VEU was designated, its parent has filed for bankruptcy. What will happen to the export authorization now?

The VEU program has been not only a selection failure, but also a verification cripple. Even now, on-site VEU reviews in China require a 60-day notice and must be arranged and accompanied by Chinese Government officials.

And what are the inspection procedures for India's first VEU designation detailed just last week?

Given these fundamental flaws, limitations and uncertainties, the VEU scheme should be scrapped. At the very least, a moratorium on new designations should be imposed as Congress studies whether the program can operate without undermining our security.

Another example is the Entity List maintained by BIS. A mirror of VEU, the list is supposed to inform exporters about foreign entities that pose a risk of diversion, especially to WMD programs, but the list is incomplete and out of date. Some entries are now inaccurate, and others are not usable.

My organization has published and submitted to BIS concrete proposals for updating this national security resource. Despite our hopes, BIS has made none of these changes. The list now has more names tied to smuggling, but it is not more accurate or clear and has lost its focus on nonproliferation. Congress should press BIS to make the Entity List a real tool for exporters to screen their transactions and prevent diversions.

This subcommittee has taken a leadership role in addressing the risks of transshipment and diversion of dual-use U.S. goods. I would like to offer for inclusion in the hearing record an updated chronology documenting how Dubai and other points in the United Arab Emirates have served for decades as the main hubs in the world for nuclear and other smuggling. We have also seen such activity channeled through Malaysia and other countries with weak export controls.

Another facet of this problem is what you, Mr. Chairman, alluded to in your opening statement, domestic sales of controlled dual-use goods. There are things that we can do to meet these challenges as well. I have listed some examples in my written testimony and would be happy to discuss them.

In conclusion, I would like to mention that the challenges I have discussed today have been exposed and publicized through the work of this subcommittee and others. Congress should expand and systemize this oversight and enlist other investigators to help it.

For example, the GAO should be tasked with the review of export records and BIS licensing decisions every year. Congress should also use help from the Inspectors General of the relevant Federal agencies.

Thank you.

[The prepared statement of Mr. Shulman follows:]

**TESTIMONY OF ARTHUR SHULMAN  
GENERAL COUNSEL  
WISCONSIN PROJECT ON NUCLEAR ARMS CONTROL**

**Hearing on the Export Administration Act:  
A Review of Outstanding Policy Considerations**

**House Committee on Foreign Affairs  
Subcommittee on Terrorism, Nonproliferation, and Trade**

**July 9, 2009**

I am pleased to appear before this distinguished Subcommittee to discuss dual-use export controls, and their role in stemming the spread of mass destruction weapons.

I will cover four topics. First, the importance of strong and effective export controls for U.S. national security; second, the resources and authorities required to enable our export control officials to do their jobs properly; third, the need to improve industry's ability to police itself; and fourth, ways to address the risks of transshipment and diversion at home and abroad.

*A matter of national security*

The Export Administration Act (EAA) is the foundation of our system for controlling the export of dual-use, militarily sensitive technologies from the United States. For most of the last two decades, this key statute has been in lapse. The dual-use export control system has continued to operate on an emergency basis, under the authority of the International Emergency Economic Powers Act (IEEPA). Efforts to reauthorize the EAA have been driven by industry, seeking to lower controls under the guise of "modernizing" the system and making it less "burdensome" and more "efficient." The Export Administration Act remains in lapse because Congress, in its wisdom, has refused to undermine our national security by adopting these proposals.

Are dual-use export controls a burden on U.S. industry? The facts speak for themselves. An analysis by the Government Accountability Office (GAO) showed that in 2005, 99.81 percent of exports subject to the Export Administration Regulations (EAR) left the United States without an export license, including 98.5 percent of items on the Commerce Control List. And even for the tiny fraction of dual-use trade that required an export license, the Commerce Department denied only 1.4 percent of the license applications it processed during that period (FY2005), while lowering processing times. Two years later, denials were at 0.88 percent. One almost wonders, what's left for industry to complain about?

The focus of export control reforms should be on ensuring that the system protects U.S. national security in the 21<sup>st</sup> century – not on removing the remaining speed bumps on the export superhighway. While the EAA has been in lapse, the export control system has not been updated to reflect the post-Cold War and post-9/11 security environment. The GAO has lamented the absence of a comprehensive, public analysis of the current security challenges, how the dual-use export control system is meeting these challenges, and what changes are needed. Commerce apparently

conducted an ad hoc review after the events of September 2001, but decided that no fundamental changes were needed. Thanks to the efforts of this Subcommittee, our nation's arms exports will be subjected to a comprehensive national security review if H.R. 2410 becomes law. The same must be done for dual-use trade. Only then would we have the hard data needed for thinking about a new Export Administration Act – one that would protect our security in the present and future.

In the interim, we must ensure that the current system is working well to protect us. In many ways, it is not, but there are things we can do now to change that. Congress should give the Bureau of Industry and Security (BIS) at Commerce enough resources to do the job it has now. Congress should also provide robust oversight to ensure that those resources are being used well.

#### *More for Export Enforcement*

I would like to note a recent article by Darryl Jackson, formerly Assistant Secretary of Commerce for Export Enforcement. Mr. Jackson notes the need for the dual-use export enforcement officials in the Bureau of Industry and Security to carry out their crucial mission with “maximum effectiveness.” Export enforcement agents need to be able to conduct investigations abroad, to go undercover and to set up wiretaps, to deter and punish criminals by seizing profits and assessing higher penalties. Mr. Jackson suggests that Congress pass a standalone bill immediately that would give OEE permanent law enforcement authority. This Subcommittee introduced just such a provision last year in H.R. 6828, and should do so again in this new Congress.

Another issue is that BIS export enforcers do not have sufficient personnel and funding. At present, OEE has more than 800 open cases - but fewer than 100 special agents to work them, throughout the country. These staffing and resource levels have remained static for years – but violators have not. The budget request for FY2010 would provide an additional 3 persons to OEE. That is a start, but not enough. Additional staff and resources for enforcement should be a priority for Congress.

#### *Safer Export Administration*

Additional resources would also help with another problem. During several lean years, BIS has tried to shrink its workload by doing away with license requirements. An example is the “Validated End-User” (VEU) program, which I discussed in my testimony before this Subcommittee last year. Launched in 2007, the program allows select foreign companies to receive controlled dual-use goods without otherwise-required export licenses. An interagency committee is supposed to choose companies and locations posing little or no risk of diversion. But our initial report on the program, published in January 2008, revealed that two of the first five Chinese companies designated as VEUs were closely linked to China's military-industrial complex, to Chinese proliferators sanctioned by the United States, and to U.S. companies accused of export violations. BIS hand-picked those companies, tellingly noting that they accounted for 18% of licensed U.S. exports to China. And BIS reportedly estimated that the next batch of five Chinese VEU candidates would account for 90 percent of exports to China subject to BIS licensing, when combined with the original five VEUs. Since then, one additional VEU was designated in April (the other four candidates are presumably still in the pipeline). My organization analyzed this designation, and our analysis revealed that components useful in gas centrifuge enrichment plants

can now be shipped, without limits or prior scrutiny, to a building that houses the headquarters of a Chinese company which, as recently as December, was under U.S. sanctions for proliferation to Iran and/or Syria. I ask that this analysis be made part of the record for this hearing.

The VEU program has been not only a selection failure but also a verification cripple. In January, BIS finally secured Chinese consent to the post-shipment inspections required under the program. That's eighteen months after the program's launch, and over a year after the first VEUs were freed to receive sensitive exports license-free. In the interim, the GAO highlighted the risk of unverified license-free exports and pointed out other flaws in the program. Yet even now, on-site VEU reviews require a 60-day notice and must be arranged and accompanied by Chinese government officials.

Given these fundamental flaws and limitations, the VEU scheme should be scrapped. At the very least, a moratorium on new designations should be imposed, as Congress studies whether the program can operate without undermining our security. The VEU program and other "trusted customer" initiatives decrease our government's role in controlling sensitive exports. This creeping abrogation of a key national security function is highly risky. By eliminating the pre-shipment checks performed by licensing officers, the responsibility for spotting and preventing diversion attempts shifts even more to the exporter - who may lack the necessary training and resources - and to customs officials, who may lack the ability to screen license-free exports adequately before they leave U.S. ports. Congress should scrutinize such initiatives closely, and ensure that they are not driven by resource shortages at BIS.

*More help for industry to protect our national security*

Industry is the first line of defense in our current system for controlling militarily useful trade. Nevertheless, industry is still not getting enough help from the government in safeguarding our safety. One example is the Entity List maintained by BIS. The List is supposed to be a primary means for informing exporters about foreign entities that pose a risk of diversion - especially to mass destruction weapon programs around the world. An exporter usually must apply to BIS for a license before selling a controlled item to an entity on the List. But, as I explained in my testimony last year, the List is incomplete and out of date, especially its China section. Some entries are now inaccurate, and others are not usable.

Despite criticism from auditors and requests from industry and national security advocates, little has been done to improve the List. My organization has submitted to BIS concrete proposals for updating this crucial national security resource. Last year, we grew tired of waiting and posted on our website (at [www.wisconsinproject.org](http://www.wisconsinproject.org)) an annotated version of the Entity List's China section, complete with updated entity names (including in Chinese) and addresses.

Despite our hopes, however, BIS has made none of these changes. The agency did finally commit to annual reviews of the List. But so far, the review process has only resulted in removals of listed entities. The agency has also instituted a formal petition process for removal from the list - and has already removed one company as a result. There is no corresponding public procedure to request addition of risky end-users. BIS has also begun to use the List to identify entities not directly linked to proliferation or to terrorism, but implicated in various smuggling networks, for example. So, the List now has more names, but it is not more accurate or clear, and has lost its focus

on nonproliferation. Congress should press BIS to make the Entity List a real tool for exporters to screen their transactions and prevent diversions.

#### *Combating Illicit Transshipment and Diversion*

This Subcommittee has taken a leadership role in addressing the risks of transshipment and diversion of dual-use U.S. goods. Last year, I testified about the history of illicit transshipment through the United Arab Emirates (UAE). I would like to offer for inclusion in the hearing record an updated chronology documenting how Dubai and other points in the UAE have served for decades as the main hubs in the world for nuclear and other smuggling. Authorities in the United States and elsewhere are still bringing criminal cases against smugglers shipping dangerous goods through the UAE. We have also seen such activity channeled through Malaysia and other countries with weak export controls – expanding the geography of this threat.

A recent GAO investigation highlighted another aspect of the problem – domestic sales. Using a credit card and little else, the GAO was able to buy a variety of highly sensitive items controlled for export, including switches usable for triggering nuclear weapons. Since the items were first delivered within the United States, little or no scrutiny of the sales was required by law. Then, the investigators shipped dummy versions of the items to a country known as a transshipment and diversion point, entirely evading customs scrutiny of the exports. This operation reproduced a scheme used repeatedly by those intent on illicit acquisition of controlled dual-use technology from the United States.

There are things we can do to meet these challenges. For instance, additional resources would allow BIS to expand its successful program of outreach visits to industry – particularly smaller businesses. Such visits increase awareness of export control requirements and diversion threats, and often lead to tips about suspicious acquisition attempts. In addition, BIS must get more staff and resources to verify abroad that exported sensitive technology ends up and remains in authorized locations and uses. And both Customs agencies should be given direction and resources to prioritize export control review of outgoing shipments and verification of industry self-policing activities.

Revisions to the Automated Export System (AES) proposed by this Subcommittee last year in H.R. 6828 also hold great potential. Mandatory, real-time linkages and automated cross referencing could be set up between export license data, shipment information and enforcement records. Such automation would make work by export compliance and enforcement officials much more efficient, by flagging problem transactions for investigation before they cross the border. The AES revisions would also help exporters, by facilitating classification decisions and by automatically screening transactions against restricted party lists. Such services are now available commercially, but they are too expensive for smaller businesses. Government should make these crucial decisions easier for exporters, without relieving them of responsibility for knowing their products and customers.

We should also do all we can to encourage systematic reporting by industry of suspicious acquisition attempts. So far, only a handful of individual companies in Europe and the United States have established such relationships with their regulators. Systematic reporting by industry would generate a tremendous amount of data, which could be analyzed and used to uncover and defeat

proliferation networks. Industry should also be incentivized to embed anti-diversion technology – including tracking chips and immobilizers – in sensitive equipment controlled for export. A few companies do this already, but more widespread adoption of such measures must be encouraged. On the other hand, robust enforcement and heavy penalties must also be maintained, to punish criminals and to deter the reckless and the would-be violators.

Finally, the United States should do more to convince our friends and allies to maintain effective controls on strategic trade, and to supply practical training and assistance to countries trying to do a better job. But those who refuse to do their part, and who facilitate dangerous trade through their territories, should not be spared. The UAE continues to be a problem in this regard. The Mayrow network was based there, allegedly sending to Iran U.S.-origin components used to make the improvised explosive devices killing our soldiers in Iraq and Afghanistan. Iran continues to import large quantities of goods through Dubai's revolving door, posing a grave security risk and circumventing sanctions efforts. Congress must continue to demand real export control improvements by the UAE, and should attach conditions to that effect to any agreement for nuclear cooperation. At the same time, we need broader tools to motivate and punish countries which do not adopt effective export controls as required by United Nations Security Council resolution 1540. Congress should legislate the “destinations of diversion concern” concept, which would impose greater controls on trade with such diversion facilitators.

*Oversight remains necessary*

The challenges I've discussed – the flawed VEU program, weak Entity List, and others – have been exposed and publicized through the work of this Subcommittee and others. Congress should expand and systematize this oversight, and enlist other investigators to help it. For example, the GAO should be tasked with reviewing export records and BIS licensing decisions every year. Such reviews generate valuable data for checking whether the system is protecting our security.

Congress should also use help from the relevant Inspectors General. Until recently, the Inspectors General of the Departments of Commerce, Defense, Energy, and State, in consultation with the Director of Central Intelligence and the Director of the Federal Bureau of Investigation, were required by statute to assess whether export controls and counterintelligence measures are adequate for preventing the acquisition of sensitive U.S. technology and technical information by countries and entities of concern. The Inspector General at the Department of Homeland Security also participated in these reviews. The Inspectors General identified numerous shortcomings, prompting improvements. These reviews should be re-instituted and made permanent.

Mr. SHERMAN. Thank you for your presentation. I look forward to talking to you about controlling domestic sales of some of these items.

Mr. SHULMAN. Yes, sir.

Mr. SHERMAN. Now we will go on to Owen Herrnstadt, director of trade and globalization for the International Association of Machinists and Aerospace Workers.

The machinists union represents several hundred thousand workers in more than 200 basic industries in North America, and his organization has been helpful in teaching me that it is not always favorable to jobs to just open things up; that it is not just business activity versus national security, but that sometimes when you allow exports you are actually hurting jobs.

With that, I would like to hear from the witness.

**STATEMENT OF OWEN HERRNSTADT, ESQ., DIRECTOR OF TRADE AND GLOBALIZATION POLICY, INTERNATIONAL ASSOCIATION OF MACHINISTS AND AEROSPACE WORKERS**

Mr. HERRNSTADT. Thank you very much, Mr. Chair, and thank you for your invitation to appear before you today.

As you noted in your opening, and we appreciate your comments regarding the serious nature of exports and jobs. As you also just noted in my introduction, the machinists union represents several industries. We truly understand the importance of exports.

We are troubled that our Nation's export strategy has yet to embrace policies that ensure the creation of jobs here at home. Among other things, comprehensive and detailed employment impact analysis is not undertaken when transactions are reviewed that could involve outsourcing to other countries, specifically the transfer of technology and production to current and potential competitors.

Given the current job crisis, the importance of export controls and suggestions concerning the reauthorization of the EAA, a discussion of how the current export system can be improved to include consideration of its impact on domestic employment is highly critical.

It is no secret that U.S. workers—indeed, our entire economy—is in a crisis; 6.5 million workers have lost their jobs since December 2007. Nearly 2 million of these workers are in the manufacturing industries. Our unemployment rate is at 9.5 percent and many predict it will shoot to 10 percent and will stay high for the next several months.

Industries like manufacturing, aerospace, electronics and many others that were once the bedrock of our Nation's economy are barely shadows of what they once were. Our economic security and our physical security diminish with the loss of these basic industries and the jobs they provide.

As the nation grapples with the current economic crisis, Congress and the administration must explore new measures to ensure that our overall export strategy supports the creation of jobs here at home. We can start by discarding the presumption that any policy that promotes exports is automatically good for U.S. workers and the long-term growth of domestic jobs. Attention must be paid to export programs and unregulated outsourcing arrangements that can and do result in the loss of jobs.

My colleague seated to the right talked briefly about the Validated End User program. It serves as a classic example that neglects meaningful employment impact review. The machinists protested one of the initial programs that was adopted by the VEU. In the announcement of the entire program, the Under Secretary stated that it would be good for U.S. jobs.

In our protest, we said given the massive loss of jobs that we have experienced in the United States aerospace industry over the past 20 years, the increase in aerospace production in China in general, the recent announcement that China is planning on entering the large commercial aircraft industry and China's continued use of transferred production and technology from the United States aerospace industry enabling it to accomplish these tasks, we find it very difficult to believe that your actions regarding one specific VEU program are good for U.S. workers or the U.S. economy.

Another example where employment impact reviews are much needed involves the virtually unregulated category of outsourcing that presents a serious threat to our Nation's economy and our physical security, that known as offsets, the transfer of production and technology in return for jobs.

They are significant, they are increasing, and we are losing thousands of jobs to the use of offsets. They create foreign competition that comes back to further hurt our job prospects. The decimation of our skilled workforce also presents a serious danger if a situation occurs in which a rapid buildup of defense production is required.

In view of the national, economic and security interests that are threatened by offsets and other offshoring arrangements like the VEU program, export control policy must be improved to ensure that it is in fact assisting in the creation and maintenance of jobs here at home.

Here are four very brief recommendations for your consideration: 1) Shining a light on current export policy to determine with precision its employment impact on the domestic workforce; 2) Strengthening offset reporting requirements so that agencies like the Bureau of Industry and Security apply a meaningful and precise employment impact analysis to all offset deals which come under its jurisdiction; 3) Undertake efforts to eliminate offset and offset-like activities through all of our international negotiations; and 4) Form a national commission to review export policy and its impact on U.S. employment by including labor, academic, members of the industry and of course the government to join together to figure out solutions for this critical, critical area.

Mr. Chairman, I would like to submit my written testimony for the record, as well as a report which I reference in my written testimony on offsets as well.

Thank you.

[The prepared statement of Mr. Herrstadt follows:]



**Testimony of  
Owen E. Herrstadt  
Director of Trade and Globalization, International Association of Machinists and  
Aerospace Workers  
Before the House Committee on Foreign Affairs' Subcommittee on Terrorism  
Nonproliferation and Trade  
"The Export Administration Act: American Jobs and Security in the 21<sup>st</sup> Century"**

**July 9, 2009**

The International Association of Machinists and Aerospace Workers (IAM) represents several hundred thousand active and retired workers in North America. Our members work in a variety of industries including aerospace, manufacturing, transportation, woodworking, shipbuilding, defense and electronics. Given the nature of these industries, the IAM truly understands the importance of exports. We are troubled, however, that our nation's export strategy has yet to embrace policies that ensure the creation of jobs here at home.

We are particularly concerned that our current system of export controls fails to incorporate detailed employment impact analysis into its decision making process. Among other things, comprehensive and detailed employment impact analysis is not undertaken when transactions are reviewed that could involve outsourcing to other countries, specifically the transfer of technology and production to current and potential competitors. Given the current jobs crisis, the importance of export controls, and suggestions concerning the reauthorization of the Export Administration Act, a discussion of how the current export system can be improved to include consideration of impact on domestic employment is critical. We welcome the opportunity to appear before you today to share with you our views on these critical and timely matters.<sup>1</sup>

It is no secret that U.S. workers and the communities where they live, are in a crisis. Over five million jobs have been lost since December 2007. The unemployment rate has surged to 9.4% with many economists predicting that it will grow higher in the coming months. Industries like aerospace, electronics, machine tool, shipbuilding, textiles, and many others that were once the bedrock of our nation's economy are barely shadows of what they once were.

Our economic security diminishes with the loss of these basic industries and the jobs they provide. It is no coincidence that our nation's current economic crisis coincides with this massive loss of jobs. Jobs and the economy are intertwined: the economic crisis leads to a loss of jobs and the loss of jobs leads to an economic crisis. After all, without a strong economy who can stay in business and employ workers? In turn, without good jobs that earn decent pay, who can afford to buy the goods and services that fuel our economy?

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<sup>1</sup> Portions of this testimony are directly taken from my paper, *Offsets and the Lack of a Comprehensive U.S. Policy: What Do Other Countries Know That We Don't?* EPI Briefing Paper No. 201, April 17, 2008. A copy of this paper has been attached to this testimony.

Supporting domestic jobs is not only about restoring our economic health: it is also about preserving our national security. Without a strong manufacturing industry, and without a strong defense industrial base, our nation becomes more vulnerable to present and future dangers. As jobs and the skills needed to perform them disappear and as our defense capacity dwindles, we will become less able to defend ourselves should the need arise.

As the nation grapples with the current economic crisis, Congress and the Administration must explore new measures to ensure that our overall export strategy supports the creation of jobs here at home. We cannot presume that any policy that promotes exports is good for U.S. workers and the long-term growth of domestic jobs. Attention must be paid to export programs and unregulated outsourcing arrangements that can and do result in the loss of U.S. jobs.

The Validated End-User Program (VEU) is a classic example of an export control program that neglects meaningful employment impact review. In its announcement of the VEU program, the Bureau of Industry and Security (BIS) claimed that, “The steps we are taking today are good for American exporters and jobs...The increased trade with China will help to keep high paying, good quality technology jobs in the United States.”<sup>2</sup> In its announcement, BIS cited the approval of VEU status for “Boeing Hexel AVIC I Joint venture (BHA) composites manufacturing facility”.<sup>3</sup> The facility “produces composite parts for secondary structures and interior applications for commercial aircraft, including the Boeing 787.”<sup>4</sup>

IAM President R. Thomas Buffenbarger disputed the contention that approval of the program would be good for U.S. workers. As he stated in a letter to the Undersecretary of Commerce, Mario Mancuso:

“Given the massive loss of jobs that we have experienced in the U.S. aerospace industry over the past 20 years, the increase in aerospace production in China in general, recent announcements that China is planning on entering the large commercial aircraft industry, and China’s continued use of transferred production and technology from the U.S. aerospace industry enabling it to accomplish these tasks, we find it very difficult to believe that your actions are ‘good’ for U.S. workers or the U.S. economy. The work involving composites could be performed in the United States by U.S. aerospace workers instead of being outsourced to China. This is just one more example of how U.S policy actually costs workers jobs and opportunities here at home.”<sup>5</sup>

For this reason, as well as for national security concerns described by the Wisconsin Project on Nuclear Arms Control, Buffenbarger requested that the program be suspended.

<sup>2</sup> Bureau of Industry and Security, *New BIS Program Changes Export Rules on Targeted Products For Select Companies in China*, press release, October 18, 2007.

<sup>3</sup> Ibid.

<sup>4</sup> Ibid.

<sup>5</sup> Letter from R. Thomas Buffenbarger to Mario Mancuso, Undersecretary of Commerce, January 4, 2008.

Another example where employment impact reviews are much needed involves a virtually unregulated category of outsourcing that presents a serious threat to U.S. workers, our economy and our national security: a little known arrangement referred to as “offsets”. Offset activities involve the transfer of technology and production from the U.S. to another country in return for a sale. While offsets are virtually unregulated in the United States, other countries have well established policies that are feeding the development of their own industries and employment by bringing U.S. productive capacity and technology to their shores.

Traditionally, offsets have been divided into two categories, direct and indirect. Direct offsets involve technology and/or production directly related to the purchased product. For example, the production of part of a fighter jet is transferred to another country in return for that country purchasing the fighter jet. Indirect offsets involve transfers of technology, production or other innovative schemes unrelated to the product being purchased. For example, in return for an agreement by one foreign government to purchase a jet fighter made in the United States, the U.S. producer of the fighter agrees to find someone in the United States who will purchase a totally unrelated product from a company in the foreign country.

While government definitions of offsets refer to the defense industry, offsets and offset like activities also occur in the commercial industry. Given the complexity of offsets, their growth, and the nature of dual-use technologies, it is not always easy to distinguish between the effects of offsets in the defense and commercial industries.

While more precise information is needed regarding offset transactions, what we do know about offsets in the defense and commercial industries is disturbing, particularly in terms of its direct impact on U.S. employment and our security. While virtually no government reports are required for the commercial industry, the U.S. government does gather some information regarding offsets in the defense industry. These reports indicate that offsets are significant and increasing.

Over a 15-year period, 1993 to 2007, U.S. companies reported over 9,200 offset transactions, valued at \$45.73 billion to 48 countries.<sup>6</sup> A previous U.S. government report concludes that, “16,323 work-years annually associated with the offset transactions completed in the period 2002-2005” were lost.<sup>7</sup>

While it is not easy to estimate the number of jobs that have been directly lost due to offset deals because there is no requirement that they be reported, anecdotal evidence suggests a serious impact. For example when the offset with respect to the F-15 program in Korea was announced several years ago, news accounts reported that it would create

<sup>6</sup> *Offsets in Defense Trade* (Hereinafter referred to as “Department of Commerce”), 2008.

<sup>7</sup> *Offsets in Defense Trade, 2007, Section 3-3*; The Report concludes however that on balance more jobs “were maintained by defense exports associated with offset agreements” during the same period. The methodology used by the Bureau of Industry and Security (BIS) to conduct the study was subject to serious criticism, including fundamental assumptions concerning certain factors, such as relying on the supposition that value added per employee was based on 100 percent U.S. content; see discussion in *Offsets in Defense Trade, 2007*, and *Offsets and the Lack of a Comprehensive U.S. Policy*, supra at fn. 1, for further elaboration on flaws in BIS employment impact calculations.

several thousand jobs in South Korea involving work that was once performed by workers in St. Louis.<sup>8</sup>

Other countries recognize the value of a comprehensive offset policy for their country's employment and take offsets seriously. Europe has lead the way in establishing comprehensive offset programs and over 20 European countries have offset agreements. The size of their offset demands can be enormous. As reported by the U.S. Department of Commerce:

“The average offset percentage demanded by the 17 European countries involved in offset activities during the eleven-year reporting period (1993-2003) was 101.2 percent of the export contract values...the average offset percentages for Europe have exceeded 90 percent in each year since 1999, reaching a peak of 148.8 percent in 2003, up from 94.3 percent in 2002.”<sup>9</sup>

In addition to the direct loss of jobs, offsets have a deep impact on industries in the long term as prime contractors ship work offshore. Suppliers located in the U.S. are especially hard hit as it appears that their work is often the first to be transferred to another country. At the same time, other countries develop powerful industries that come back to compete fiercely with U.S. based companies, causing further job loss.

This trend will become even more problematic in the future as advanced industries like aerospace spin off to other countries and opportunities for U.S. development of new technologies are lost. Moreover, technologies that have supported multi-billion dollar markets will likely relocate to other countries, further disadvantaging the United States and its workers.

As offset arrangements have grown and become more creative and difficult to track, national security concerns have emerged involving three different but related matters: 1) As offsets foster greater offshoring and increased foreign competition, our manufacturing sector is eroded, threatening our defense industrial base; 2) National security is further threatened when technology that is intended purely for commercial use is part of an offset to another country and ultimately ends up being used for defense purposes; and, 3) The decimation of our skilled workforce presents a serious danger if a situation occurs in which a rapid build-up of defense production is required.

In view of the national economic and security interests that are threatened by offsets and other offshoring arrangements like the VEU program, export control policy must be improved to ensure that it, in fact, assists in the creation and maintenance of jobs here at home. Policy proposals for achieving this task include:

- *Shining a light on current export policy to determine with precision its employment impact on the domestic work force.* The federal government should adopt, develop, and implement employment impact statements that would be

<sup>8</sup> Sec. Dinc, Philip. 2002. “Sub-assembly deal with S. Korea may hinder future Boeing sales; ‘set-aside’ work was done here.” *St. Louis Post Dispatch*, May 22.

<sup>9</sup> U.S. Department of Commerce 2005a, Section 4-3.

completed prior to consideration of matters concerning export controls. For example, companies seeking export licenses subject to current restrictions should be required to report if the export in question involves the transfer of production or technology to another country and whether this transfer will result in the direct loss of jobs here at home. The employment impact statement should also include an analysis of how many jobs will be created or maintained in another country by the arrangement and whether the transfer could foster growing global competition that could result in the loss of U.S. jobs in the future. The completed statement should then serve as a major consideration in reviewing the matter.

- *Strengthening offset reporting requirements so that agencies like the Bureau of Industry and Security apply meaningful employment impact analysis to all offset deals which come under its jurisdiction.* BIS should make every effort to determine how many jobs have been lost due to offsets and what employment impact offsets will have in the future. It should also review how foreign countries have used offsets with U.S. firms to contribute to employment in their countries. In addition, BIS should analyze the impact that offsets have had on the demise of several manufacturing industries, including shipbuilding, aerospace, and machine tool.
- *Undertaking efforts to eliminate offsets and offset like activities.* These efforts should be made a priority by the U.S. in a variety of international forums, including the WTO, trade negotiations, investment agreements, and strategic economic dialogues.
- *Forming a national commission to review export policy and its impact on U.S. employment.* Making certain that determinations concerning export controls include consideration of domestic employment is only one element of strengthening our economy. A comprehensive effort must be undertaken across the government to ensure that our export policy is being utilized to the fullest extent possible to assist in the creation and maintenance of jobs at home. Experts from industry and labor, joining with representatives from academia and government will be a vital component in this effort.

As the nation grapples with the current economic crisis, and what it means for our future, we must adopt new approaches to export controls that will have a meaningful impact on U.S. workers and their communities. Incorporating strong measures that will make certain our export policies assist in the creation and maintenance of good jobs here at home is crucial if we are to succeed in building a strong, vibrant economy and in preserving our nation's security.

Mr. SHERMAN. Without objection it will be entered in the record, as well as the full opening statements of the other witnesses.

With that, Mr. Scott, did you want to go first?

Mr. SCOTT. Sure. I will be glad to.

Mr. SHERMAN. I will recognize the vice chair of the subcommittee to go first with questioning and then move to the Republican side.

Mr. SCOTT. I would like to kind of focus my questions on the national security aspect both at home and abroad and its economic implications.

Export control reform attempts to balance national security interests with the promotion of a vibrant economic environment for the United States businesses to export their products. In the post September 11 world, national security concerns are of paramount importance, and with that in mind, understanding the impact of exports on the economic climate here at home in the United States is critical.

So I would like to ask a series of questions with that backdrop first with you, Mr. Herrnstadt. I am very moved by your testimony, and I think it would be well if you could share with us just how dramatic in numbers in comparison of time in terms of the job losses that you refer to due from offsets.

How many jobs are we talking about? Over what period of time? In other words, just how impactful are these job losses? Yes.

Mr. HERRNSTADT. Thank you. I would be glad to respond.

Let me preface this by saying with one of the serious problems with offsets is that there is so little amount of information that is actually known. Some information is reported in the defense industry to the Bureau of Industry and Security.

Mr. SCOTT. Do me a favor, Mr. Herrnstadt, because a lot of times we have these hearings they are made public through C-SPAN. Just for the benefit, what are offsets?

Mr. HERRNSTADT. Okay. Very good. As I explained in my written testimony, offsets are when another government institutes an industrial policy that says we will buy your good, but only if you transfer some of the technology related to that good or some of the production related to that good to one of the companies in our country in return for the sale.

Roughly 20 European countries have exceedingly sophisticated offset policies. At times those offset policies say that we will only buy your good unless you offset to us production or technology that sometimes exceeds the value of the sale item itself.

So, for example, if a country wants to buy a jet fighter they will say we will buy your jet fighter, but we want to do some production in our country. Offsets get even more complicated because sometimes the traded item under the offset may not even be related to the weapons system involved. It could involve something well, like a printing press, for example, that has nothing to do with it.

The point of offsets is that other countries realize that this is a mechanism they can use to employ their workforce and to get their industries going. Our own Government has very little policy itself that impedes the use of offsets.

One of the specific problems we have is that very little information is known about offsets because these are primarily private con-

tracts that occur between one company and another government or another company in that country.

Mr. SCOTT. Okay. Now, because my time is short, give me a number. Give us a number to hang onto. How do you quantify the job losses?

Mr. HERRNSTADT. Okay. Well, the Bureau of Industry and Security at one point estimated that the number of job losses that occurred due to offsets were roughly around 16,000 jobs or so a year.

But as I point out in my written testimony, they also say those were offset—unrelated to the term offset—by jobs that were created because the sale went through. We dispute that claim for a variety of reasons, which are found in my written testimony.

But that is just defense-related offsets. Those don't even include the job losses that occur in the commercial industry because, quite frankly, there is very little information that is given. Workers certainly don't know about it because they are not told about it by companies.

Mr. SCOTT. All right. Well, thank you for that.

I know my time is up. Mr. Sherman, if we have another round at this I would like to ask everybody on the whole jobs area just how our U.S. jobs in particular are affected by the totality of export control regulations and have our export controls been a factor in the outsourcing of U.S. jobs.

So maybe we will get around to that the second time. I don't want to overextend here.

Mr. SHERMAN. We will do a second round. We kept these witnesses waiting. I see no reason not to keep them here when they can talk to us since they were here for hours not talking to us.

With that, I will ask the gentleman from Illinois if he has any questions.

Mr. MANZULLO. Well, thank you very much. I have a couple of questions.

Mr. Herrnstadt, did your organization take a position on the cap in trade bill that just passed?

Mr. HERRNSTADT. Yes. I mean, we took the same position that Labor did, the AFL-CIO and others did.

Mr. MANZULLO. Governor Engler, could you tell us what impact the cap in trade had on our exports and our ability to manufacture in this country?

Could you press the button please, Governor?

Mr. ENGLER. I am sorry. Labor opposed the cap in trade legislation, didn't they?

Mr. MANZULLO. My question is—

Mr. HERRNSTADT. We are concerned specifically with the trade issue involved with the cap in trade program. We are also very concerned with the effect that it will have on our own manufacturing industries here.

Mr. MANZULLO. So you were opposed to the bill that passed this past week?

Mr. HERRNSTADT. I have to double check on exactly what our position was on that, to be quite honest with you on it.

I know that our concerns were primarily job-related on it, and we were also concerned with making certain that developing countries weren't given an exception.

Mr. MANZULLO. Okay.

Mr. HERRNSTADT. Yes.

Mr. MANZULLO. Okay. Governor Engler, if I could ask you? I know you come from a state that has just a little bit of unemployment, and I think Illinois is right behind you.

The general question, and I understand we will have a second round here, is I think you share my concern that this administration or this Congress has put no emphasis upon restarting manufacturing in order to build our way out of this recession as opposed to just spending all types of money coming from the top.

As a person who understands manufacturing, do you agree with that statement? If so, could you give us your thoughts on that?

Mr. ENGLER. A couple of things. Certainly we think manufacturing is the key to wealth creation and growth. The United States remains the number one manufacturing economy in the world, but we are under challenge from all over the world, and a strategy to maintain the U.S. leadership and to expand opportunities for workers of this country comes through the development of new products and new markets.

Those markets can certainly be domestic if we were to say take on the major challenge of renewing our infrastructure in the country. That could be enormously helpful. At the same time, we are only 4–5 percent of the world's population. There are a lot of growth opportunities and expanding markets around the world, and we would like to be able to compete for those.

One of the concerns with the issue specifically in front of the committee today is that in the area of export controls we sometimes as a country choose to control products that are widely available in the marketplace, and therefore we simply through our controls take ourselves out of the opportunity to compete against the German, French, Italian, Japanese company.

We would argue that in some of those cases the consequence of that is specific to job loss and company exiting of those lines of products and businesses here.

Mr. MANZULLO. And that is heard. I know you are familiar with Rockford, Illinois. We used to be called the machine tool capital of the world.

When I was elected in 1993 I think the U.S. had a 17 percent market share of machine tool sales in the world. Now we are down to about seven. One of the reasons is we have become an unreliable supplier. It is very difficult for countries to buy a for-access machine tool in this country.

Could you elaborate on that, Governor, and the impact that that has on domestic jobs?

Mr. ENGLER. Sure. I think if the tooling—again, tooling is subject also to its own innovation and so you want to continue to improve your products that have markets. If we are not able to sell those products to the broadest possible market, the global market, then other competitors will rise up, meet those needs and suddenly their innovations are outpacing ours.

It isn't just in the production cost of the machine. There is much more than the mere labor cost or the materials cost. It is the whole intellectual property behind that machine and the capabilities of that machine. I would say these machines today are all smart ma-



chines with chips. We don't make any of those chips in this country now, save what Intel does, which is substantial, but a lot of that is gone.

I would argue, Congressman, that export controls are a factor in this. Nobody would say this is the total reason at all, but it is a factor and it is one that is fixable.

Mr. MANZULLO. Thank you. We are going to have another round of questions? Thank you.

Mr. SHERMAN. We hope to unless a vote is called on the floor. We are not going to ask these gentlemen to wait for another 40 minutes or so for us.

The GAO report urges that we suspend the Validated End User program with China. I would like each of the witnesses to comment on if we just got rid of Validated End User with China would that have a positive or negative effect on jobs? Mr. Herrnstadt?

And really it goes down to, are the exports to China real exports or are they the offshoring of processing?

Mr. HERRNSTADT. I think you are asking a good question, and one of the questions that we have raised with the VEU program is does anyone count if this does have a direct impact on jobs. I mean, obviously we thought that one of the programs certainly did.

Mr. SHERMAN. We can always do a study and put things off for a few years, or should we just end the program with China?

Mr. HERRNSTADT. I think we should just suspend it at this point.

Mr. SHERMAN. Governor, do you have an argument that we should continue to have a Validated End User program with China, especially given the fact that we have been able to reach a Validated End User specific inspection program with China?

Mr. ENGLER. Well, I think to the credit of the Obama administration that has now been reached. In January, the Department of Commerce and MFCOM signed an agreement that would allow BIS to do these end user reviews.

The five companies—five. Not exactly a program running rampant here, but the five companies that are in the program. I think we should continue that. I think it certainly should be monitored, and we ought to test the agreement. The idea was to create trusted entities.

Mr. SHERMAN. Are those entities buying goods for use in China or are they simply processing goods to ship back to the United States?

Mr. ENGLER. They are for use in China is my understanding.

Mr. SHERMAN. Mr. Herrnstadt, do you have any specific information on this, or Mr. Shulman?

Mr. HERRNSTADT. No. I would just encourage the committee to take a look at the Commerce Secretary Mancuso's at the time announcement of the VEU program.

One of the programs involved the work of composites done in the aerospace industry in China. Mr. Shulman and his organization have also described that, and I think that had to do with production that was moved to China or at least initiated in China.

Mr. SHERMAN. Mr. Shulman, what if we went with a program in which we controlled fewer things, but we had internal U.S. controls so that you couldn't just send in an order for a spark gap plug?

Would that be a system that would better control the spread of technologies, or do you endorse a system of controls at the border rather than controls at the factory gate?

Mr. SHULMAN. It is a very tough question, Mr. Chairman. I think there are more incremental things that we can do to deal with the domestic sales problem. I think we probably ought to be checking and controlling both at the factory and at the border.

Mr. SHERMAN. Governor?

Mr. ENGLER. Well, actually I don't think it is that tough. It is bureaucracy that needs some good, firm guidance from the Congress because we really need harmonization by Customs and Border Protection.

You have one sort of numbering or classification system that BIS uses, and then you have Custom and Border Protection with different numbering, and simply bringing that together—presumably we are not caring about what is actually happening internal in the country. We are caring about what might happen outside the country.

Mr. SHERMAN. As a practical matter, if we do not impose on American business the additional bureaucracy of having to license certain small portable items and we continue the policy the spark gap plug can be sold to anyone with a post office box in the United States, then we have no control over spark gap plugs.

The GAO study proved what I think everyone in this room knows, and that is you can put a small item in an envelope and mail it to Venezuela.

So the question is do you see the members of NAM willing to accept that certain products which have a very high military value and which are highly portable cannot just be shipped to any P.O. box in the United States just because the customer paid for it?

Mr. ENGLER. Well, if we are asking if instead of the Department of State say processing 100,000 export licenses we get the most important 5,000 and look at those carefully, I think we could talk.

The idea is if we are going to go from 100,000 to 200,000 that would probably be headed in the wrong direction.

Mr. SHERMAN. I am not even talking about Department of State here because it would not be an international transaction.

But when a GAO employee posing as a ne'r-do-well is able to buy a spark gap plug and have it shipped to his P.O. box anywhere in the country that is a problem, and the solution to that problem imposes additional bureaucracy on your members.

I think that would have to go hand-in-hand with reducing the bureaucracy imposed on your members in other ways.

Mr. ENGLER. Sure. I think I would be happy to talk about that.

Now, I don't know if you can buy the same thing if we are the only people in the world that have that particular item and you can't buy that in Germany or you can't buy that somewhere else if it is just a question that we are strictly the only ones today that have that.

Mr. SHERMAN. As I laid out in my opening statement, among the things we need to look at are how portable is the item, what is its military significance, does it have many civilian legitimate users and, finally, is it widely available around the world.

I believe I have gone over and will recognize our ranking member, Mr. Royce.

Mr. ROYCE. Thank you, Mr. Chairman. I wanted to ask Mr. Shulman a question, Mr. Chairman, and this goes to the hearing that you and I participated in the other day on the UAE.

Mr. Shulman, you testified that the pending nuclear cooperation agreement with the UAE should be held up in your view unless UAE makes real export control improvements. I guess they adopted a stronger law in 2007, but haven't implemented it yet or haven't put the regulations in place I take it.

But the supporters claim that the UAE made these improvements. You raised this point. I was going to ask you your thoughts on that, on how long a track record of improvement should the UAE have before the agreement is approved?

And then I guess the key point, should the agreement ever be approved given proliferation concerns beyond UAE's export control record? And so just your thoughts on that.

Mr. SHULMAN. Thank you, sir. Our sense is that consideration of approval of the 1-2-3 agreement with the UAE should involve a real examination of efforts by the UAE to improve their export controls.

As you mentioned, they passed this legislation 2 years ago. They just held I believe the first meeting of the committee, which will be charged with administering it, a month or 2 ago and announced their intention to really enforce this legislation.

Part of the problem, one of the things that could be done fairly easily I would think is both for our Government and for the Government of the UAE to make more public whatever efforts the UAE is doing to actually improve their export control policy and practice because very little is known about it now.

It may be that they are doing things that we just don't know about, but in any case what is known so far is that there are still export control cases being brought both by the United States and other governments involving smuggling to Iran and other places of very dangerous items going through Dubai and other Emirates.

Certainly more needs to be done by the UAE to really prove that they are headed in the right direction.

Mr. ROYCE. Let me ask you another question on the same kind of subject.

In 2007, the Commerce Department proposed the creation of another category, a C category, Country Category C I guess is what you would call it, which would list countries of diversion concern, and as a consequence those countries would be subject then to a much stricter requirement for export licensing.

So that was the concept back then. It was never implemented. Was it a good idea? Which countries in your mind would belong in such a category if we ever did take this up a notch and create Category C? It is kind of a unique way to approach the problem.

Mr. SHULMAN. I think it is definitely a good idea. I think it should be implemented, and I think the first two countries, based on the information that we have seen, the first two countries that ought to be considered for such a designation would be the UAE and Malaysia.

Mr. ROYCE. I see. Let me ask you. The Obama administration has been in office 5 months now. Could you give me your assessment? What can be said about its export control policies at this point?

Mr. SHULMAN. I don't think too much can be said so far in part because at the Department of Commerce the relevant officials have not been appointed yet, so I think we will have to wait and see once they are in place what it is that they do.

Mr. ROYCE. I guess my time is about expired here. Let me ask Mr. Herrnstadt a question.

Mr. Engler describes a very competitive global environment, an economy in which an increasing number of countries will be challenging the U.S. in developing and designing and manufacturing cutting edge technology. He also states that the rate of technological advance is so fast today that products are obsolete within months.

I was going to ask if you agree and, if so, how your proposals then cope with those realities.

Mr. HERRNSTADT. I think he obviously has raised a very good point. Our concern is that we don't have an export control policy in this country that the offshore of technology and production discourages to other countries.

Many times by merely giving another country technology that enables them to build a platform upon which to even produce more advanced technology, comes back to hurt our own businesses, hurt our own workers and our own communities. It creates the global competition that we are currently facing. And that is a real concern. It is a concern that we are hearing from our members, that we are seeing occur all the time.

Let me point out in the paper I wrote on offsets, specifically, I focus on the aerospace industry and China and how Europe and the United States have transferred lots of technology in terms of aerospace to China. Guess what? China is now in the regional aircraft market, and they announced that they would be entering the large commercial aircraft market to give Boeing and Airbus a run for their money. So I think we need to formulate a comprehensive policy that addresses this.

Mr. SHERMAN. The gentleman from California, Mr. Rohrabacher?

Mr. ROHRABACHER. Thank you very much, Mr. Chairman. I would just like the panel to give a very brief answer if you could.

Do you think that United States developed technology has played a significant role in the developing of this massive Chinese economic challenge that we face today?

Mr. ENGLER. I will go first, Congressman. There is no question that just as I suppose in the early days of this country European technology helped us, there is no question that American technology has played a role over there.

Mr. ROHRABACHER. The answer is yes.

Mr. ENGLER. Yes. Absolutely.

Mr. ROHRABACHER. One difference of course is that when we were young we didn't throw religious believers in jail, and we had a fledgling democratic government.

They still have an intransigent communist dictatorship which, as far as I know, as we speak is shooting Uighurs down in the streets,

arresting Falun Gong members for their religious freedom, as well as the Tibetan people.

Mr. Shulman, do you think that United States technology has played a significant role in developing China into the threat that it poses to us today?

Mr. SHULMAN. Yes.

Mr. HERRNSTADT. Let me say yes, and let me say they are doing a wonderful job of playing Europe and the United States against one another to drain that technology off.

Mr. ROHRABACHER. Right.

Mr. HERRNSTADT. A good example is the Airbus A320 that was just assembled in China.

Mr. ROHRABACHER. Right. Governor, when you said Intel has gone, where did Intel go?

Mr. ENGLER. No. No. I said Intel is really the remaining chip maker that is here.

Mr. ROHRABACHER. Okay. Where did the rest of them go then?

Mr. ENGLER. Singapore, Ireland, lots of places.

Mr. ROHRABACHER. Okay. But you don't see chip manufacturers going to Ireland as a problem? Is that right?

Mr. ENGLER. I am reporting it as a fact.

Mr. ROHRABACHER. I know.

Mr. ENGLER. I would like to have it all here. When I was Governor of Michigan, I wanted it all in Michigan.

Mr. ROHRABACHER. Okay. See, I don't see any problem with trading with Ireland or maybe even Singapore.

I do find it troubling when we send technology to China that could come back to hurt us. I understand the People's Liberation Army owns many manufacturing systems in China, and that seems to me to be a travesty.

When we talk about U.S. technology going to these other countries, is much of this technology not just technology developed by our own companies, but also aren't we also talking about technology that was developed by the United States taxpayers?

Mr. ENGLER. I think one good example, and Congressman Royce asked this question of Mr. Shulman. I would just comment the UAE is committed to spending I think \$40 billion on the nuclear industry. No question. We know where that all got started. That started here.

We were the leaders, and much of the technology that started here is why France is able to generate 80 percent of their electricity from nuclear power, why Japan has got a robust nuclear power industry. Now China is building nuclear power plants. We should be doing that here.

The UAE is going to do them. The question is do we want any U.S. jobs as a result of their \$40 billion expansion? There is simply nothing that is not available from France or other places in the world for the UAE.

Mr. ROHRABACHER. Correct me if I am wrong. Isn't this an issue of whether we should work with them in building up a nuclear capability there versus the idea of sending technology to a country which then will manufacture, using that in a manufacturing process?

Mr. ENGLER. The way I would say it, and maybe we are saying exactly the same thing, but since I am not sure the way I would say it is simply they have made a commitment to spend \$40 billion on a nuclear power industry for domestic energy purposes. We have a chance to be major suppliers or not.

Mr. ROHRABACHER. Yes.

Mr. ENGLER. We should approve the 1-2-3 agreement 1-2-3, real fast.

Mr. ROHRABACHER. You know, I guess when we talked earlier about a dual track, there are different layers to this onion.

One layer is that we don't want someone to get a hold of a piece of technology that can also be used against us both militarily and economically, but when we are talking about some technologies what we are really talking about is the technology that would enable them to expand their manufacturing capabilities so that our aerospace workers which now have leverage on slave labor because we got technology in place—

Well, if you give that same technology to slave labor countries that undercuts our abilities if they use it in manufacturing. Does that make sense?

Mr. HERRNSTADT. Yes, it does. I actually testified on this point before the China Economic Security Review Commission on the growth of China's aerospace industry. I think that is a real risk that we run. It is something that we talked about for many years.

Mr. ROHRABACHER. Right. Because we don't really worry that the United Arab Emirates is going to go into the business of building nuclear power plants for people in competition with General Electric or something here.

What we are really worried about in UAE is whether or not there is going to be a nuclear power plant that could be used for military purposes.

Mr. ENGLER. I think that is true, Congressman, although I do think that some actually worry that if that were to happen they would prefer that it would be said that somehow the technology came from the French, not the United States.

Mr. ROHRABACHER. Thank you, Mr. Chairman. Let me just note with one last statement, and that is we have subsidized this massive development in China with technology transfers, with educating young Chinese graduate students, with knowledge that will permit them to basically put our own people out of work. I think that has been not thoughtful on our part.

Thank you very much, Mr. Chairman.

Mr. SHERMAN. Since so much of your questioning dealt with the jobs and the UAE and their nuclear program, I will reprise what I said about that when we had hearings about it in this room, and that is—the word is—“the fix is in.”

The French are going to get the lion's share of the jobs in return for France doing a little thing that will help UAE security, namely building a French naval base in that area.

We provide massively for their security; in fact, they would have been overrun by Saddam had we not organized—not France, but we organized—the effort to liberate Kuwait, and our State Department has made it excruciatingly clear to UAE that they are free to give us just the crumbs and they will still get the massive secu-

urity umbrella we provide, and then they can get an additional security enhancement from France if they give them the lion's share of the jobs. So it is not surprising that the UAE is going to do this.

Years ago they decided to buy a French phone system, and I commented that when you dial 911 on a French phone system you get Paris, not the Pentagon, but what the UAE has correctly deduced is that they can get all of the United States security commitment and diplomatic support without anybody in our State or Defense Department concerned about the jobs aspects.

With that I want to recognize the gentlelady from California, Diane Watson.

Ms. WATSON. Thank you, Mr. Chairman, and I thank the witnesses for their patience and being here. If I raise an issue that has already been addressed, would you please let me know?

In the absence of an Export Administration Act, the U.S. dual-use export control system continues to be dependent on the President's invocation of emergency powers under the International Emergency Economic Powers Act and no comprehensive legislation to rewrite or reauthorize the EAA was introduced in the 110th Congress.

Given the state of today's economy and the threat of global security, what problems do you foresee in the near future if significant effective legislation is not passed in the 111th Congress? Any of you gentlemen can respond.

Mr. ENGLER. Well, I guess at this table as the primary advocate for the rewrite for commercial purposes, I see U.S. companies being left off of bid opportunities in some of the international products where you actually have bids being submitted by saying no export control approvals required, that kind of thing.

I think that you will see competitors who have goods that are export controlled in this country commercially available, and they will compete more effectively and will cost us job opportunities, so I really think at a time when we are in a recession we ought to be saying what are all of the things we could do to create potential opportunities.

This happens to be one that I think is low-hanging fruit that we could do. I know we have been busy the last 30 years, but it is time to rewrite and modernize the Act.

Ms. WATSON. Mr. Shulman?

Mr. SHULMAN. Yes, ma'am. I think that there is much that we can do to modernize and make the system more effective and efficient for industry and for national security without undertaking a rewrite of the EAA at this time for the purpose of dealing with these problems as quickly as possible in the current economic climate.

Ms. WATSON. What are some of those things that you might have in mind?

Mr. SHULMAN. Well, for one I think it is imperative to allocate more resources to the Commerce Department, to the Bureau of Industry and Security, to replenish their staff, which they have lost many, many quality people in the last few years because they have been operating effectively in a hiring freeze.

Ms. WATSON. Yes.

Mr. SHULMAN. To dedicate more resources to administering the export control system to make it work more quickly and more effectively, to devote more resources to create resources for industry and for exporters to make export control decisions, classifying their items, trying to determine whether they are controlled for export or not, informing them of potential buyers in other countries of whom they should be wary.

Those are all things which could be done just with additional resources dedicated to BIS.

Ms. WATSON. Mr. Herrnsstadt?

Mr. HERRNSTADT. Yes. Just very quickly, and I will direct you to my written testimony.

We believe that part of the component of any relook at the current EAA should give consideration for some sort of employment impact study so that when export control licenses are considered there is an analysis about how many jobs this will impact at home in the short-term and then in the long-term in terms of a transfer of technology and production.

Ms. WATSON. Thank you. Should the U.S. designate specific countries as sinners of transshipment concern and impose additional restrictions on exporting to those destinations? Thoughts?

Mr. ENGLER. I believe that is the law and that we do do that, but I don't have a problem.

Ms. WATSON. Well, if you need any changes, what would they be?

Mr. ENGLER. Well, I would take the list of all of the covered products and reduce that rather sharply and dramatically so that we were able to put our regulatory enforcement focus on those particular items that represent the greatest threat where we uniquely have that product in this country where the same product isn't available from one of our allies who is willingly selling it.

And in some cases I suspect even if the ally is willing to sell it we should not. I don't argue that point, but I think we are quite over broad today because the Act is outmoded.

Ms. WATSON. Mr. Shulman?

Mr. SHULMAN. Yes, ma'am. I believe that there have been both regulatory and legislative proposals to create a special designation for countries of diversion concern. I believe such a designation should be created.

Two of the countries that have been mentioned as candidates for such designation are the United Arab Emirates and Malaysia because of their history of diverting things to Iran.

Ms. WATSON. Thank you so much. My time is up, Mr. Chairman.

Mr. SHERMAN. Mr. Herrnsstadt, we have talked free trade. A wonderful thing. We will export. We will import without governmental involvement.

Then you bring to our attention these offset agreements and co-production agreements. Is it fully legal under our various trade treaties for us to impose such requirements on those exporting to the United States?

Mr. HERRNSTADT. Well, it gets a little complicated for us. There is the government procurement provision under GATT 1979. There is a separate agreement under GATT dealing with civil aviation of which we are a signatory to.



Mr. SHERMAN. But China is able to do this if you are exporting paperclips to them.

Mr. HERRNSTADT. They are not a signatory to the civil aviation agreement. And then there was the 1992 United States-European agreement on large commercial aircraft which got dissolved with respect to the WTO subsidy.

So part of our argument is that we really need to reinvigorate prohibitions on the use of offsets in free trade agreements, in multilateral trade agreements, at the WTO and in investment—

Mr. SHERMAN. Well, these other countries are going to look at their agreements with us and they are going to say we don't want to change those. They are pretty sweet for us.

I realize you are here representing the machinists and not the UAW, but are we allowed to require co-production and technology transfer and offsets to anyone who wants to export a vehicle to the United States?

Mr. HERRNSTADT. You know, I will confess I will need to take a double look at it, but my immediate reaction is I would be interested to see why we couldn't do it, particularly in the commercial arena.

Mr. SHERMAN. Well, it is because our free trade agreements are designed to be one-sided in favor of American investors and importers.

I believe the Governor is a little bit more in favor of free trade agreements than most members of organized labor. I ought to let him comment. Do you see a circumstance where we have to put up with offsets and co-production agreements, but we are not able to impose them on anybody shipping into the United States?

Mr. ENGLER. Well, I do think that it is a pretty competitive world out there, and some of these agreements—I mean, I am proud. For a long time General Motors has been number one in China with the Buick. I mean, that is a good thing.

Mr. SHERMAN. Well, that is the example of a co-production agreement. General Motors gets the profits, but the UAW doesn't get the jobs.

I am sure that a lot of countries will welcome our investment and our technology so long as none of the manufacturing benefits American workers. If that is a big win, a few more wins like that and we are going to be a third rate country.

Do you see the Buicks made in China as the route to prosperity for the future?

Mr. ENGLER. Unfortunately, I see them being more profitable than the vehicles being made in the North American market at the moment.

I do think that the fact that China is now the largest auto market in the world, passing this country, probably would argue that if you are a global auto company you would want to be there and be in some production.

Mr. SHERMAN. As of a few years ago, we were the largest auto market in the world, and lots and lots of big auto companies decided not to give us our fair share of the jobs, and many of them sold cars in this country without giving us a single manufacturing job.

It is hard to say, well, China is a big market so we have to give them a lot of jobs, and we are a big market so they have to avoid giving us any of the jobs as long as we get the profits.

Mr. ENGLER. You know, the government is in charge of the auto industry or a good deal of it today. I am sure it will be fixed, but the reality I think is—

Mr. SHERMAN. The government is in charge of two companies in the auto industry that account for way less than half of the autos sold in the United States.

The fact is whether we are talking autos or we are talking textiles or whether we are talking anything else, when we want to export to many countries they hit us hard with co-production agreements. When they want to export to us, we just fire a bunch of employees. We just fire a bunch of workers and open our markets.

Let us see. I see my time is expiring. I did want to go on to another line of questioning, but I will recognize the gentleman from Illinois.

Mr. MANZULLO. Thank you. I am going to show my age, especially with Frank Vargos sitting behind you.

Do you remember the battle of Three Gorges Dam? For the younger members here, when I was first elected and sworn in in 1993, Ex-Im Bank would not allow a company such as Caterpillar and Rotec and others to use the favorable financing of Ex-Im to go into the massive Three Gorges Dam project in China because of concern over the Siberian crane and Chinese alligator.

We were arguing for massive change in our Ex-Im policy that allowed the U.S. to be more competitive because if our products are going there they were more environmentally safe than the products that were eventually purchased because of favorable financing.

I think that is a reasonable analogy or a good analogy as to several things that we are trying to do here. UAE is going to buy their nuclear equipment from somebody. The issue is from whom are they going to buy it, and if they buy it from us we have the opportunity to put in the strongest set of verifiable controls that can be envisioned because we have a great interest obviously in making sure that there is no more nuclear proliferation going on.

Governor, is that not really what we are talking about in terms of modernizing export controls so we can be on the cusp to have the best controls possible and yet to be able to have as much manufacturing and engineering here in this country?

Mr. ENGLER. Congressman, that is exactly what this discussion is about. I mean, we are ranging far afield today, which I always enjoy the discourse, but I think this is a fairly narrow set of issues here.

The UAE would like to buy American products for that nuclear expansion. I mean, I met with UAE officials. That would be very high on their list. We need to get out of the way, and the 1-2-3 agreement is part of that. I think that that has been made pretty clear. I think that we would be highly competitive if in fact we removed the obstacles.

And you are absolutely correct. They made the decision to spend \$40 billion in this area. They are going to buy from somebody, and because we have been so sort of hostile to nuclear power for a num-

ber of years the industry in this country has been pretty dormant, but all of that technology started here.

So I see this as an opportunity to operate the supply base as a precursor to a renewal of a nuclear power industry in this country that is urgently needed, especially if we are serious about reducing carbon emissions.

Mr. MANZULLO. And would you not call those green jobs?

Mr. ENGLER. They don't get any greener than that. They are green in terms of the environment, and they are green in terms of the cash.

Mr. MANZULLO. That is a great answer.

Mr. Shulman testified that 99 percent of dual-use exports do not require licenses. He suggests that the manufacturing industry is complaining essentially over nothing.

Mr. ENGLER. Well, we have thousands and thousands and thousands of products, and many of them don't require any license, but many do. Many of those unfortunately are also readily available elsewhere in the world.

Mr. MANZULLO. That was the 17C fix that Mr. Sherman—

Mr. ENGLER. Yes.

Mr. MANZULLO. We worked on last year.

Mr. ENGLER. And I am just suggesting that we can be more discerning in an Act which references the Cold War written 60 years ago really last touched 30 years ago.

It is time to bring that into this century, and in so doing I think we can do a better job for national security on the things that really matter while clearing away just what really has become a regulatory morass.

The big companies could really afford this. Interestingly enough, I think the companies who get hurt the most by this are the small and medium sized companies who don't have an army of lawyers working for them. The big people staff up, and they just do it. They hate it and it is expensive, but they do it. Medium and small sized companies can't. They can't do it.

Mr. MANZULLO. I want to thank the three of you for your testimony. Weren't you the panel that got caught up in the 6 hours of voting a couple weeks ago? Sorry for that.

Mr. SHERMAN. Does the gentlelady from California have additional questions?

Okay. Well, then I will call on myself for a few questions.

Mr. Shulman, how much harm is it that BIS currently does not have law enforcement authority?

Mr. SHULMAN. They have found a way to work around that problem, but it requires effort which would be better spent on doing export enforcement with the limited resources that they already have, so it seems to me that it could be a relatively simple fix to give them that permanent law enforcement authority, freeing them up to do their jobs better.

Mr. SHERMAN. Governor, we have a deemed export definition where even if you are shipping a good in the United States if you are shipping it to a foreign national then you need the same license as if you were shipping it abroad.

That legal fiction, but useful one, could be useful in saying for certain items, and I keep coming back to the spark gap plug, that

we are going to deem it an export even if you are sending it to someone whose folks came over on the Mayflower.

That is to say if it leaves the factory gate we are going to want to keep track of it and know where that item is going and that you are sending it to somebody who has a legitimate use for it. Is this something that we should apply to some easily transportable, highly militarily significant products?

Mr. ENGLER. You know, it is something that I think is part of the discussion of the Modernization Act that can be looked at.

I was part of a commission that started out being co-chaired by Bob Gates and Norm Augenstein and ended up being chaired by Augenstein after Gates was appointed to the Defense post that recommended a number of changes in the export law as well, so that is an area that is useful to look at.

The other thing that we haven't talked about today, but I think it is also relevant because again it helps to clear this up, is that we have companies that are cleared that we work with very closely in our most top secret areas. We don't allow those companies the kind of flexibility on intracompany transfers from this country to another country.

We have got now negotiations, and earlier we were talking about a list of countries that we might not trust. There are countries we do trust, Australia and Great Britain, and we have defense treaties pending there that need to be acted on, so there are lots of ways to look at this and to narrow the focus down to those few things that are most important.

Mr. SHERMAN. So the verified end user program might apply to a company that is already dealing with the most sensitive—

Mr. ENGLER. Sure.

Mr. SHERMAN [continuing]. Technology that has a branch in a foreign country, particularly if that foreign country was a place we trust.

I don't care how much I like Google and Yahoo, but when they do business in China all of a sudden they are turning over all kinds of documents to the Chinese Government that we would prefer they not.

Mr. Herrnstadt, I can see why the machinists would fear competition from a low wage country. Most of those countries the Governor is referring to are not low wage countries.

Do you see a threat to jobs if we make it easier for a United States company with a branch in Australia or Britain to move goods from here to there and back more easily?

Mr. HERRNSTADT. Yes, we certainly do. It is not just an issue with a developing country. The developing country issue particularly with labor standards not met, internationally recognized labor standards, like Mexico and China exacerbate the situation, but yes. Certainly.

Mr. SHERMAN. I mean, Australia probably has better labor standards than we do and certainly stronger unions I hate to say.

Mr. HERRNSTADT. Well, we will give the Rudd government a little bit more time.

Mr. SHERMAN. But you would want the same job scrutiny whether we are talking about an end user certificate—

Mr. HERRNSTADT. Absolutely.

Mr. SHERMAN [continuing]. In Australia as with China or Mexico?

Mr. HERRNSTADT. Yes. Absolutely. The problem with offsets is that basically our Government's policy is to relegate the issue of offsets to private parties, so we have private companies negotiating either with countries or companies in other countries regarding the offset process.

Mr. SHERMAN. I would also comment the biggest problem with offsets is they tend to exist only in those very few areas where the United States is a net exporter, chiefly aircraft and some high technology, and if we are going to have balanced trade on the one or two things that we export and then we are going to have massive deficits in everything we import then our trade deficit is going to get much worse.

And that is why it is interesting that these co-production agreements only seem to exist when America is exporting and only as to those few goods where America still tends to be a net exporter.

I believe we have gone long enough, and the gentleman from Illinois has no more questions. Gentlemen, you have been very patient with us, and I thank you for your appearance.

We would be anxious to get from each of you proposed if not statutory language, at least something close to statutory proposals to improve this whole system because we can't write it all ourselves.

Mr. ENGLER. We would be happy to work with you, Chairman.

Mr. SHERMAN. Thank you.

[Whereupon, at 2:05 p.m., the subcommittee was adjourned.]



# A P P E N D I X



MATERIAL SUBMITTED FOR THE HEARING RECORD

**SUBCOMMITTEE HEARING NOTICE**  
*Committee on Foreign Affairs*  
**Subcommittee on Terrorism, Nonproliferation and Trade**  
*U.S. House of Representatives*  
*Washington, D.C. 20515-0128*

**Brad J. Sherman (D-CA), Chairman**

June 19, 2009

**TO: MEMBERS OF THE COMMITTEE ON FOREIGN AFFAIRS**

You are respectfully requested to attend an OPEN hearing of the Subcommittee on Terrorism, Nonproliferation and Trade, to be held in **Room 2172 of the Rayburn House Office Building**:

**DATE:** Thursday, July 9, 2009

**TIME:** 10:00 a.m.

**SUBJECT:** The Export Administration Act: A Review of Outstanding Policy Considerations

**WITNESSES:** The Honorable John Engler  
President and Chief Executive Officer  
National Association of Manufacturers  
*(Former Governor of the State of Michigan)*

Arthur Shulman, Esq.  
Senior Research Associate  
The Wisconsin Project on Nuclear Arms Control

Owen Hermstadt, Esq.  
Director of Trade and Globalization Policy  
International Association of Machinists and Aerospace Workers

**By Direction of the Chairman**

The Committee on Foreign Affairs seeks to make its facilities accessible to persons with disabilities. If you are in need of special accommodations, please call 202/225-5621 at least four business days in advance of the event, whenever practicable. Questions with regard to special accommodations in general (including availability of Committee materials in alternative formats and assistive listening devices) may be directed to the Committee.

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COMMITTEE ON FOREIGN AFFAIRS

MINUTES OF SUBCOMMITTEE ON TNT MEETING

Day Thursday Date 07/09/09 Room 2172

Starting Time 10:08 a.m. Ending Time 2:05 p.m.

Recesses 1 (10:37 to 12:58)

Presiding Member(s) Mr. Sherman

CHECK ALL OF THE FOLLOWING THAT APPLY:

Open Session [x] Electronically Recorded (taped) [ ]
Executive (closed) Session [ ] Stenographic Record [x]
Televised [x]

TITLE OF HEARING or BILLS FOR MARKUP: (Include bill number(s) and title(s) of legislation.)
The Export Administration Act: A Review of Outstanding Policy Considerations

SUBCOMMITTEE MEMBERS PRESENT:
Mr. Sherman, Mr. Scott, Ms. Watson, Mr. McMahon, Mr. Klein, Mr. Royce, Mr. Manzullo

NON-SUBCOMMITTEE MEMBERS PRESENT: (Mark with an \* if they are not Members of HIRC.)
Mr. Rohrabacher

HEARING WITNESSES: Same as meeting notice attached? Yes [x] No [ ]
(If "no", please list below and include title, agency, department, or organization.)

STATEMENTS FOR THE RECORD: (List any statements submitted for the record.)
Statements of the Witnesses, Members' Opening Statements

ACTIONS TAKEN DURING THE MARKUP: (Attach copies of legislation and amendments.)

RECORDED VOTES TAKEN (FOR MARKUP): (Attach final vote tally sheet listing each member.)

Subject Yeas Nays Present Not Voting

TIME SCHEDULED TO RECONVENE
or
TIME ADJOURNED 2:05 p.m.

[Signature]
Subcommittee Staff Director

**COMMITTEE ON FOREIGN AFFAIRS**  
**SUBCOMMITTEE ON TERRORISM, NONPROLIFERATION AND TRADE**  
U.S. HOUSE OF REPRESENTATIVES  
WASHINGTON, D.C. 20515

**Donald A. Manzullo (IL-16)**  
**Opening Statement**

July 9, 2009

Mr. Chairman, thank you for calling this important hearing to examine the Export Administration Act (EAA). Congress must pass an updated EAA that is relevant to the both the needs and threats of the 21<sup>st</sup> century, and we can't begin soon enough. Fundamental reforms to our nation's export control system are necessary for both our national security and our global competitiveness, and I truly believe we are facing a rare opportunity to accomplish measurable progress in export control reform.

As you well know, the EAA has not been updated since the end of the Cold War despite several attempts by Congress. New threats to our national security have emerged over the past 15 years while, unfortunately, our primary control regime for dual-use items has remained focused on protecting technology transfers to the defunct Soviet empire. The U.S. government must establish an export control policy based on clearly defined national security and foreign policy priorities that also recognizes the realities of a global supply chain and encourages legitimate trade. It is clear that overly broad controls are actually detrimental to U.S. national security interests as well as our overall global competitiveness.

When we talk about dual-use items adversely affected by export controls, I can think of no better – or more timely – example than thermal imaging cameras. We all know that night vision equipment is vital to America's operations in Iraq and Afghanistan and is a key component to our defense superiority. There are also growing commercial applications for thermal imaging cameras, from checking the structural integrity of railroad tunnels to screening people for infectious diseases. But global market share for U.S. thermal imaging companies has fallen significantly in the last few years because of overly broad and restrictive controls.

These technologies and products are readily available in other countries that do not unnecessarily restrict the sale of these products, and the end result has been the loss of technological "know how" and leadership of U.S. companies to foreign competitors. The continued loss of U.S. leadership in producing these technologies could irreparably damage the U.S. defense industrial base and pose a permanent threat to our national security if we are forced to rely upon foreign governments for our most basic defense technologies and supplies.

Last September, BIS initiated a review – at the request of one of department's Technical Advisory Committees – of the export controls on certain thermal imaging cameras and assessed their foreign availability. Recognizing this growing foreign availability, BIS issued a final rule just last month that revises the export licensing requirements for certain thermal imaging cameras. While imposing license requirements on exports that incorporate certain thermal imaging cameras, the new regulations removed Commerce Control List (CCL)-based export and

re-export license requirements for 36 destinations – mostly European countries – for certain thermal imaging cameras, with a couple of caveats.

I hope they will take similar steps in the near future on machine tools. One company that I represent in the 16<sup>th</sup> District of Illinois is losing sales right now to foreign competitors that don't have to struggle with system like ours.

The authorities under the EAA officially lapsed **eight** years ago during the last major attempt to pass export control reform. Since then, any attempts to reauthorize and modernize the system have failed because of entrenched views held by one stakeholder or another. Congress, the Administration, and industry all seem to agree, though, that the current system does not adequately meet U.S. foreign policy, national security, and economic objectives.

Recent efforts to reauthorize the basic EAA statute without any underlying reforms other than enhanced penalties have not gone far enough to address the realities of business in the 21<sup>st</sup> century. The proposal by Senate Banking Committee Chairman Chris Dodd last year, for example, concentrated on the need for higher penalties and greater enforcement authority without addressing other much-needed reforms. I support expanded enforcement authorities to the Commerce Department's Bureau of Industry & Security (BIS), but these higher fines and penalties can only be part of the solution. I am concerned that moving a narrow EAA reauthorization bill will satisfy just one faction of the stakeholders interested in this issue; thus providing little incentive for them to negotiate other critical changes needed to update our export control regime. I believe that key elements of reform include:

- Removing all references to the Cold War, making the new export control system better able to respond to new threats to our national security – terrorism and the proliferation of weapons of mass destruction.
- Accounting for globalization by recognizing the increased role of civilian technology for military applications; and
- Making the Wassenaar arrangement a more effective multilateral export control regime by providing incentives in the form of defense technology sharing, re-export policies, and intra-company transfers if member countries develop a more strict export control regime, perhaps starting with the United Kingdom, Australia, and Canada.

If we can't find consensus on these concerns, a simple short-term extension like the one that passed the House in the 107th Congress, would be an appropriate template for a stopgap EAA reauthorization bill that would allow time for the stakeholders to come to an agreement on a comprehensive EAA rewrite. If we go this route, I will strongly recommend the creation of a commission – a public/private partnership – that will thoroughly analyze U.S. export control laws in the context of a more globalized society and deliver to Congress an EAA proposal that particularly accounts for foreign availability.

I would urge the committee to reject any EAA reauthorizations similar to the version introduced in the 109th Congress (H.R. 4572). Some of those penalty provisions could cause

significant problems for small manufacturers who may make minor paperwork mistakes simply because they do not have the time to read the Federal Register every day. Many small businesses do not have the resources for an export control compliance department, and a \$500,000 penalty could put them out of business.

The *Export Controls Improvement Act* – which I introduced last year with this subcommittee’s Chairman, my friend Brad Sherman, and Adam Smith of Oregon – would address several of these concerns by expanding enforcement authorities for BIS and also mandating updates to the computerized Automated Export System (AES). This bill, which we will be reintroducing shortly, would strengthen our current trade controls by requiring the federal government to modernize AES, making the filing process for shipments abroad more thorough and significantly reducing unintentional illegal exports. The bill also creates an accountability system for export intermediaries and enhances prosecution of exporters who attempt to circumvent electronic blocks.

I’d like to take a moment to recognize the work of the Commerce Department for aggressively pursuing export control reform within their existing framework. I appreciate their attempts to illuminate and address issues of “design out,” emerging technologies, deemed exports and intracompany transfers – among others – and hope to continue working alongside the administration as we fundamentally reform the export control system’s statutes.

I greatly appreciate the opportunity to share my views and concerns today, and I look forward to working with my colleagues on the committee in crafting a good EAA reauthorization bill. Thank you again, Mr. Chairman, for convening a hearing on this vitally important topic.

