

5. The Office of Strategic Industries and Economic Security

The Office of Strategic Industries and Economic Security (SIES) is the focal point within the Commerce Department for issues relating to the health and competitiveness of the U.S. defense industrial base. As such, SIES plays a leadership role on a wide range of issues which relate to both the national and economic security of the United States. Its efforts include assisting American companies to diversify from defense to commercial production and markets, promoting the sale of U.S. weapons systems to our allies, analyzing the impact of export controls on key industrial sectors, and conducting primary research and analysis on critical technologies and defense-related sectors. SIES includes the Defense Programs Division, the Strategic Analysis Division, and the Economic Analysis Division.

Analyses of U.S. Technology Transfers

Committee on National Security

SIES continues to provide staff support to the Under Secretary for Export Administration in his role as a member of The Committee on National Security (CNS). The purpose of the CNS is to advise and assist the National Science and Technology Council to increase the overall effectiveness and productivity of Federal efforts in areas of national security, specifically focused on research and development (R&D), international technology transfer, nonproliferation, and arms control. The CNS addresses the technical aspects of national policy, planning, and administrative matters that cut across agency boundaries. This program provides a formal mechanism for interagency policy review, planning, and coordination, as well as exchanges of information concerning R&D and technology transfer initiatives critical to maintenance of national security.

The CNS is comprised of several working groups. SIES serves as primary liaison to the International Technology Transfer Working Group (ITTWG). SIES brings the Commerce Department perspective to the larger interagency review of science and technology expenditures. This review is two-fold; it seeks to assure U.S. national security while meeting the important challenge of strengthening economic security.

SIES, in conjunction with BXA staff, is preparing several case studies for the working group to examine the complex processes involved in managing international technology transfer as well as the treatment of corresponding national security and economic issues. In Fiscal Year 1998, BXA prepared three case studies concerning the jurisdiction of commercial communication satellites for export control purposes, the international participation in SEMATECH, and the manufacture of rocket motor casings. The purpose of these case studies is to examine the government interagency process and to consider the immediate and long-term implications of

globalization and international transfers of technology. The results of the case studies will be incorporated into a “best practice” report to the CNS in the spring of 1999. This comprehensive report will address the “lessons learned” in an effort to improve the ability of the Federal Government to make effective technology-based decisions.

The ITTWG work plan for the next year includes: (1) studying the feasibility of interagency review of reciprocity and economic concerns; (2) examining the feasibility of interagency review of export control issues addressing current practices and authority to make agreements; (3) exploring the desirability of using checklists to track key issues and as an administrative tool to monitor progress; and (4) reviewing international participation in major Cooperative Research and Development Agreements. SIES will continue its important role of providing economic and industrial considerations to this critical technology program.

Commercial Technology Transfer to China

In Fiscal Year 1998, SIES, with the assistance of a consulting firm, completed an in-depth study of U.S. commercial technology transfers to China. The study highlights the dynamics faced by U.S. and other western firms when doing business with China. In particular, the study reveals the formal and informal ways in which Chinese officials use the leverage of their vast market potential to obtain industrial, technological and economic benefits from foreign investors. While not limited to the Chinese market, such commercial “offsets” are a market-distorting trade practice. While this report has not been released to the public due to the inclusion of company proprietary information, a public version is expected to be available in early Fiscal Year 1999.

In addition, SIES, again with the assistance of a consulting firm, initiated further research into the issue of commercial technology transfer to China in late Fiscal Year 1998. This research will include development of a complex database detailing U.S. and foreign technology cooperation with China in the telecommunications and aerospace sectors and will enable further analysis of the potential short- and long-term implications of these transfers for both the U.S. and Chinese economies. It is expected to be completed in late Fiscal Year 1999.

Analytic Support Activities

During Fiscal Year 1998, SIES provided research and analytic support to other BXA offices and BXA management on a variety of export control issues. For example, SIES prepared an analysis of the current and potential market for remote sensing satellites and satellite imagery, and the key domestic and international players in this market. SIES also prepared an update to an earlier assessment of the availability of foreign-origin encryption products in the marketplace, as well as foreign export control regulations of encryption products. SIES also played a key role conducting research and analysis concerning the business nature and international partnerships of numerous Indian and Pakistani Governments and private-sector entities that are potential targets of U.S. sanctions in response to these countries’ nuclear tests.

Defense Diversification Programs

In response to defense downsizing and increased international competition, SIES developed several programs to assist industry in its efforts to diversify into the commercial market. During Fiscal Year 1998, SIES expanded these programs to provide direct assistance to the defense industry, with particular emphasis placed on small and medium-sized defense subcontractors, and to communities impacted by base closures.

To assist these firms to make the necessary changes to survive in today's market, SIES continued its multi-year Competitive Enhancement and Defense Diversification Needs Assessment. Each participating firm simply completes a short survey that gathers basic information about the company and asks what type of assistance would be of benefit to it, such as manufacturing technology deployment, product/service development, R&D programs, exporting, financing, marketing, employee retraining, and business development. In Fiscal Year 1998, SIES formed partnerships with the Federal Laboratory Consortium and the Specialty Equipment Market Association which have asked SIES to survey their customers and membership. SIES modified the Needs Assessment survey slightly to better suit these audiences. The surveys will be mailed early in Fiscal Year 1999.

After analyzing completed surveys, SIES forwards summary information to appropriate members of an interagency response team who follow up directly with the firms, providing them information about the programs that their organizations offer. The team includes such diverse agencies as the National Institute of Standards and Technology, the U.S. Foreign Commercial Service, the Economic Development Administration, Department of Energy Laboratories, the Department of Labor, the Export-Import Bank, NASA Regional Technology Transfer Centers, various DOD agencies, and the Small Business Administration.

SIES continues to serve as one of six regional satellite centers for the U.S. Navy's Best Manufacturing Practices (BMP) program. During Fiscal Year 1998 SIES initiated a new outreach activity that informs Washington, D.C. area business entities of the valuable services that BMP offers. The BMP database contains more than 3,000 best practices from industry, government, and academia which have been documented by a team of impartial experts during BMP surveys. Another feature of the database is the Technical Risk Identification and Mitigation System (TRIMS), which is a process-oriented technical risk management tool. Based on a systems engineering approach, TRIMS helps the user identify and rank a project's high-risk areas, providing an early indication of potential problems.

Visitors are also made aware of the opportunity to make a contribution to industry through participation in the BMP Survey Program which documents exceptional manufacturing practices in design, test, production, facilities, logistics, and management. The non-proprietary survey information is then made available to benefit business by identifying, researching, and promoting exceptional manufacturing practices, methods, and procedures. The survey process also provides industry recognition for each of the best practices documented by the BMP survey team. Last,

firms are informed of resulting networking activities which can lead to joint ventures, technology co-development opportunities, and other valuable business partnerships.

In Fiscal Year 1998, SIES began phase one of a pilot Manufacturing Empowerment Zone project to assist manufacturing firms in the vicinity of the closing Long Beach, Calif., Naval Shipyard. This project is an outgrowth of the Competitive Enhancement and Diversification Needs Assessment survey program. SIES, with support from the City of Long Beach, the State of California, and the Department of Energy, has initiated an innovative program to reutilize the surplus equipment at the former shipyard for the benefit of the local business community.

SIES mailed more than 10,000 surveys to firms in the greater Long Beach area. The survey gathers information on such topics as firm size, growth projections, markets, employee training practices and requirements, and specific equipment needs. SIES will use this information to identify the pieces of equipment requested most frequently by local firms and match this list with the \$200 million inventory of surplus equipment at the Shipyard. Based on the survey results, Energy's Oak Ridge Centers for Manufacturing Technology will refurbish and set up selected pieces of equipment and make it available to local firms for leased time use, training, and possible purchase. Oak Ridge engineering staff will also provide companies with the necessary training to operate, maintain, and upgrade the equipment. Other communities around the country which are home to closing military bases have already expressed interest in implementing the Manufacturing Empowerment Zone concept.

Defense Industrial Base Assessments

SIES industrial base assessments are comprehensive research studies of key sectors of the U.S. industrial base. The majority of these assessments are initiated at the request of either the Department of Defense's (DOD) Secretariat or one of its service branches or at the request of an industry association or group. SIES also conducts several other types of assessments, including critical technology assessments, which are typically requested by Congress. SIES also conducts studies to determine the impact of imports on national security. These assessments can be requested by an industry, trade association, or other interested party, or initiated by the Secretary of Commerce, under Section 232 of the Trade Expansion Act of 1962, as amended.

In all of its research efforts, SIES devises industry-specific surveys to collect information from academia, foreign companies with U.S. sales operations, the U.S. Government, and U.S. companies. This is done with the assistance of industry experts, both from the private sector and other Government agencies. SIES, on behalf of the Commerce Department, has statutory authority to collect this information. The collected data serve as the core of SIES analyses, as in most cases data with this level of detail are unavailable from other sources. A brief summary of SIES analytic efforts which took place during Fiscal Year 1998 follows:

Ejection Seat Assessment

SIES conducted this national security assessment at the request of the the Crew Systems Directorate of the Armstrong Laboratory at Wright-Patterson Air Force Base in Ohio. It responded to the Congressional report accompanying the Fiscal Year 1996 National Defense Authorization Act (Air Force RDT&E on Aircraft Ejection Seats) which stated that “the committee is also concerned about the sustainment of the U.S. (ejection seat) industrial base during this period of virtually no aircraft production.”

SIES found that a sharp drop in worldwide defense expenditures for aircraft crippled the already fragmented U.S. ejection seat industry. Currently, only one firm, McDonnell Douglas, actively assembles seats. Most of the world market is dominated by Martin-Baker, a British firm, against which the U.S. industry is poorly structured to compete. In sharp contrast to the U.S. industry, which is comprised of many small firms or divisions of larger companies with small financial stakes in the industry, Martin-Baker is an integrated company dedicated to the production, servicing, and improvement of ejection seats. However, Boeing’s merger with McDonnell Douglas, plus Boeing’s long term interest in escape systems, and the future business potential (over 3,000 seats) for the Joint Strike Fighter in which Boeing is a contender, although still a decade off, could combine to revitalize a domestic capability.

Optoelectronics Assessment

During Fiscal Year 1997, SIES, in cooperation with the Optoelectronics Industry Development Association (OIDA) and DOD, initiated an assessment designed to analyze the long-term health and competitiveness of the U.S. optoelectronics industry. The assessment highlights various growth areas within the industry and identifies emerging markets for optoelectronics products. In addition, the assessment contains recommendations for ensuring that the industry can maintain its capacity to support defense-related missions and programs.

The optoelectronics industry represents a particularly important segment of the U.S. defense industrial base because optoelectronics technology has a number of critical defense applications, including data communications and telecommunications for command and control, as well as high bandwidth video transmission for intelligence, reconnaissance, display, and electronic warfare systems. This technology is also widely used in weapon-delivery platforms, sensors, guidance systems, and optical computing.

SIES initiated this assessment at the request of OIDA, which asked BXA to consider updating an earlier critical technology assessment of the optoelectronics industry (conducted in 1992-93). To obtain the industry data needed to conduct the assessment, between October, 1997 and January 1998 SIES conducted a survey of over 400 U.S. firms engaged in various optoelectronics activities. The data collected from the survey have been analyzed and compiled in a report designed to assist the optoelectronics industry in its strategic planning activities. SIES completed the draft assessment in Fiscal Year 1998 and expects to publish the finalized document in early Fiscal Year 1999.

High Performance Energetic Materials Assessment

In June 1997, the U.S. Navy's Naval Surface Warfare Centers requested that SIES conduct a study of U.S. high performance military-grade explosives and components. This request follows the 1995 SIES publication of a cartridge-and-propellant-actuated device industry assessment which was also conducted for the Navy.

The initiation of such a study is the result of significant declines in U.S. capabilities in the high performance energetic materials sector. Over the last seven years DOD's munitions budget has decreased by over 75 percent. As a consequence, a number of companies involved in producing these explosive materials have gone out of business. There is growing concern that this trend will result in some cases in higher cost end items due to lack of competition, and in other cases a lack of supply which could jeopardize national security interests.

The study involves a two-phase data collection effort, first from the approximately 40 high performance explosive suppliers to the military. This collection effort took place in the second half of Fiscal Year 1998, and analysis of the data continues in early Fiscal Year 1999. Later in the fiscal year, the second phase of the collection effort will take place. Information will be collected from the earlier-surveyed firms' immediate suppliers of critical chemicals. There is particular concern about the viability of these subcontractors, which supply specialty chemicals that are unique component ingredients without which the prime contractors will be unable to produce explosives. This study is still ongoing and is expected to be completed during Fiscal Year 1999.

Maritime Industry

At the end of Fiscal Year 1998, SIES and the U.S. Navy announced the initiation of a national security assessment of the U.S. maritime industry. Other federal agencies, including the Commerce Department's National Oceanic and Atmospheric Administration (NOAA), the Department of Transportation/Maritime Administration, the International Trade Commission, and the Defense Department's Defense Advanced Research Projects Agency (DARPA), also plan to participate in this SIES-led initiative. As with our other defense industrial base assessments, an industry-specific survey will be devised and issued to industry. This information will serve as the core of our resulting analysis. While this study is still in its early stages, it is expected that it will be completed by the end of Fiscal Year 1999.

Assistive Technologies

This new technology study, initiated in late Fiscal Year 1998, is an outgrowth of previous cooperative efforts between SIES and other agencies and associations in our defense diversification efforts. SIES has initiated this study at the request of the Education Department's National Institute on Disability and Rehabilitation Research (NIDRR) and the Federal Laboratory Consortium. Assistive technology devices enable persons with disabilities to function more fully in the workplace and in society as a whole. The purpose of the study is to identify the industry's

technology needs and match these with the defense-related technologies that are resident in the federal laboratories. An industry-unique survey has been devised and will be used to collect information to successfully make such matches. This effort is expected to continue throughout Fiscal Year 1999.

Defense Memorandum of Understanding

The review of Defense Memorandum of Understanding (MOU) is an important SIES activity. MOUs are international agreements between the United States and its allies for various types of cooperation in defense industrial and defense technological fields. Examples of such agreements include allowing a foreign country to produce a U.S. weapons system under license or, more often, establishing a cooperative R&D program for advanced military technology. SIES's role is to determine whether these agreements will result in an adverse impact on the U.S. industrial base and competitiveness of U.S. industry.

The Fiscal Year 1990 National Defense Authorization Act gave the Secretary of Commerce a unilateral option, with Presidential consent, to call for an interagency review of any MOU that Commerce believes may have significant detrimental effects on the U.S. industrial base. SIES has now reviewed approximately 732 international defense agreements since this statutory authority was delegated to the Department.

In Fiscal Year 1998, SIES continued its involvement within the interagency and bilateral consultations related to the use of technology in violation of the terms and conditions of the U.S.-Switzerland M109 Howitzer Coproduction MOU. This use resulted in a formal notification to Congress, under the Arms Export Control Act, and the resulting assessment of legal penalties for the Swiss violations.

SIES is maintaining an active role in the Production Phase MOU of the U.S.-Japan FS-X Fighter Program (now known as the F-2 fighter) through participation in the Production Coordinating Group (PCG). U.S. industry was guaranteed 40 percent of the Production Phase of the program which required a new MOU. The Production Phase MOU, which was successfully negotiated and approved by the Congress in Fiscal Year 1996, guarantees the U.S. aerospace industry a 40 percent workshare of the production of 130 aircraft during the 12-year life of the Production Phase. This program has a net direct economic benefit to U.S. industry of approximately \$4 billion.

SIES also continues to emphasize the importance of technology flowback from the F-2 program. In November 1997, the fourth in a series of SIES/U.S. Air Force-led U.S. industry technology exchange visits to Japan took place to examine the F-2 Digital Flight Control System developed by the Mitsubishi Heavy Industries (MHI) Corporation. This visit follows successful U.S. industry delegation visits in December 1995 to Mitsubishi Electric Corporation (MELCO) to examine the FS-X Integrated Electronic Warfare System (IEWS), and in November 1994 to MELCO to examine the Phased Array Radar technology. These technology exchange visits to

Japan and industry meetings facilitate U.S.-Japan company-to-company relationships and technology flowbacks to the United States. In Fiscal Year 1999, SIES will continue work with DOD to ensure access by U.S. industry to this critical technology.

Defense Priorities and Allocations System

Under Title I of the Defense Production Act (DPA), the President is authorized (1) to require that contracts or orders relating to certain approved defense and energy programs be accepted and performed on a preferential basis over all other contracts or orders; and (2) to allocate materials, facilities, and services in such a manner as to promote approved programs. In addition,

Section 18 of the Selective Service Act of 1948, and similar provisions in several other statutes, authorize the President to require prompt delivery of any articles and materials for the exclusive use of the U.S. Armed Forces. This authority to prioritize and allocate authority for resources is delegated to the Department of Commerce, and within Commerce to SIES.

In addition, a provision of the National Defense Authorization Act of 1995 amended the definition of "national defense" in the DPA to include emergency preparedness activities as defined in the Robert T. Stafford Disaster Relief and Emergency Assistance Act (Stafford Act). With Federal Emergency Management Agency (FEMA) approval, SIES staff will be able to use the DPA priorities authority for industrial resources to ensure timely industrial response to catastrophic natural disaster and other civil emergency situations.

SIES implements its authority for priorities and allocations under the Defense Priorities and Allocations System (DPAS) Regulations. The goals of the DPAS are to assure the timely availability of industrial resources to meet current national defense requirements and to provide a regulatory framework for rapid industrial response to national security emergency requirements with minimal disruption to normal commercial activities. Although the DPAS is designed to be largely self-executing, SIES can provide Special Priorities Assistance (SPA) for problems that do arise. Such assistance can include obtaining timely delivery of items needed to fill priority rated defense contracts, granting priority rating authority, and resolving production and delivery conflicts between rated defense contracts.

During Fiscal Year 1998, SIES continued to work on several SPA cases to ensure timely U.S. industrial base support for NATO's ongoing involvement in Bosnia and the deployment of U.S. and other Alliance nation peacekeeping troops to the area. Working closely with communications and computer equipment suppliers, SIES was able to significantly reduce delivery lead times for urgently needed items. SIES also continued to work with representatives to NATO's Industrial Planning Committee concerning the North Atlantic Council recommendation to Alliance member nations that they adopt priorities and allocations plans and procedures to ensure international industrial base defense cooperation in the event of a future NATO defense emergency.

Other Fiscal Year 1998 SPA cases included a request by Israel for priority rating authority to ensure timely delivery of jet engines from Pratt & Whitney; accelerating supplier deliveries of

aircraft brake components for the South Korean Air Force; and ensuring timely delivery of communications equipment for the National Security Agency, electronic components to a U.S. Navy contractor, and aircraft-mounted carrier landing hook points to the U.S. Navy. In September 1998, SIES staff worked intensively with Department of Defense and contractor representatives to deal with the sudden closing of a company that was the sole qualified source of glass for flat panel cockpit displays in Army, Navy, and Air Force aircraft, and the Army's M-1 Abrams tank. Also in Fiscal Year 1998, SIES continued to work with Federal Bureau of Investigation (FBI) contractors to ensure the timely availability of communications equipment for an urgent FEMA approved anti-terrorist civil emergency preparedness program.

As part of the interagency effort to review and update our nation's National Security Emergency Preparedness planning, policies, and procedures, and to ensure the effectiveness and efficiency of the DPAS in the post-Cold War era, SIES updated and revised the DPAS, and issued updated and revised DPAS supporting documents (i.e., agency Delegations of Authority, interagency Memoranda of Understanding, and DPAS Emergency Delegation 1).

During Fiscal Year 1998, SIES staff continued to provide DPAS training to government and industry personnel, including plant inspections and DPAS presentations to all four FBI contractors and to a lower tier supplier working on the FBI anti-terrorist civil emergency preparedness program; a DPAS presentation to Motorola's Satellite Communications group in Scottsdale, AZ; and a DPAS presentation to instructors at the Industrial College of the Armed Forces (Fort McNair, Washington, D.C.).

Defense Trade Advocacy

SIES serves as the lead organization within the Department on international defense trade advocacy issues. The Department will consider supporting conventional arms transfers only after the U.S. government determines them to further U.S. national security and foreign policy objectives. At that point, the Commerce Department determines if the transfer is also in the economic interests of the United States. If it is, the Department will support it as it would any other export that complies with U.S. laws and regulations.

SIES recommends the appropriate level of Departmental support for the transfer and generates high-level, government-to-government advocacy on behalf of the U.S. firm involved in the international defense procurement competition. SIES coordinates its efforts with the Secretary's Trade Promotion Coordinating Committee (TPCC), the International Trade Administration's Advocacy Center, and the Foreign Commercial Service posts worldwide. This process involves many branches of the U.S. government and requires the notification and approval of Congress.

In Fiscal Year 1998, SIES defense advocacy efforts supported sales of approximately \$7 billion. Examples include SIES support for the \$6 billion F-16 fighter aircraft sale to the United Arab Emirates, the \$500 million sale of Paladin howitzers to Kuwait and the \$100 million sale of radar equipment to Australia. During Fiscal Year 1999, SIES will continue outreach activities at

the major defense-related trade shows in an effort to increase awareness among small and medium-size U.S. defense firms of the important advocacy role that SIES and the Department can and do play in this highly competitive industry sector.

Economic Analysis of U.S. Export Controls

Since late 1994, SIES has the expanded responsibility for analyzing the economic impact of U.S. export control policies and export licensing decisions. During Fiscal Year 1998, SIES performed a wide array of economic impact studies on a number of critical export control issues, as outlined below.

Dual-Use Export Controls

SIES has participated in a number of activities that address the TPCC recommendation on the review of “existing unilateral dual-use export controls and policies, including those now required by statute.” Specifically, SIES has prepared analyses on the economic impact on U.S. industry of a number of unilateral foreign policy controls (e.g., controls on crime control and detection commodities, regional stability controls, and antiterrorism controls). SIES also conducts annual reviews of the economic impact on U.S. industry of U.S. foreign policy based export controls, the results of which are included in BXA’s annual foreign policy report to the Congress.

In addition to analyzing the effects of existing export controls, SIES has provided the Administration with analyses of the economic impact of proposed changes in unilateral U.S. export controls, such as proposals to tighten licensing requirements on certain crime control items (based on human rights considerations). These analyses include assessments of how the competitiveness of U.S. industries would be affected by proposed changes in U.S. export controls.

Export License Reviews

SIES also has prepared economic impact assessments to assist other offices in BXA (and sometimes other agencies, as well) in reviewing export license applications. These applications generally consist of transactions that do not clearly fall within the scope of certain export controls or licensing policies and where failure to complete the transaction would probably have serious economic consequences for the exporting company. The economic impact assessments also address the extent to which denials of individual export license applications could have a long term adverse impact on the overall competitiveness of U.S. exporters in various foreign markets.

Control List Reviews

SIES regularly provides support to BXA’s regime offices (i.e., the offices responsible for administering export controls on dual-use goods subject to control under the Wassenaar Arrangement, Nuclear Suppliers Group, Australia Group, and Missile Technology Control

Regime) by providing economic impact data that address issues such as the appropriate level of export controls for various goods and technologies. For example, SIES provides information to BXA's regime offices concerning the U.S. industry sectors likely to be most severely impacted by the imposition of new export controls or by the continuation of existing export controls. The information provided by SIES often consists of data on the international markets for specific goods, as well as major U.S. and foreign producers of such goods (e.g., semiconductor manufacturing equipment, precursor chemicals).

Industry Outreach

In an effort to more effectively perform its mission, SIES interacts with the exporters on an ongoing basis to keep them informed about SIES's role within BXA. SIES staff members have made presentations before the Technical Advisory Committees (TACs) describing the role the SIES plays in ensuring that U.S. export control officials are made aware of the economic impact that their decisions can have on individual U.S. companies, various industrial sectors, and U.S. industry as a whole. An important goal of these outreach activities is to obtain valuable feedback from the exporting community on the impact of export controls on companies and industry sectors in the United States.

Emergency Preparedness

The National Security Emergency Preparedness (NSEP) program has been the Department's focal point to ensure that the Nation's industrial/technology base can respond effectively to the requirements of national emergencies. In view of the dramatic changes in our national security strategy in the post-Cold War era, the NSEP focus has shifted to supporting the U.S. response to regional conflicts, humanitarian missions, and peacekeeping operations, catastrophic natural, accidental, and man-caused disasters, and the potential threat of violence aimed at disrupting the continuity of the Government.

As a result of this change in focus, SIES is working closely with the interagency community to support an ongoing and comprehensive National Security Council-led review of NSEP planning, policies, and procedures. This project also has included a Congressionally-mandated review of the post-Cold War relevancy and effectiveness of the Defense Production Act of 1950, a primary source of NSEP authority. Commerce is the lead federal agency responsible for industrial emergency preparedness planning and implementation of a variety of NSEP programs, and SIES has been a major interagency contributor to ongoing reviews and assessments of the industrial/technology base.

NATO Industrial Planning Committee

SIES has also continued its work in representing the United States on the NATO Industrial Planning Committee (IPC) which is responsible for coordinating industrial preparedness planning among the NATO allies. SIES plays a leading role in the IPC's industrial analysis subgroup,

whose current focus is defense industry consolidation within the NATO Alliance nations and improvements in international industrial emergency supply protocols. This work is based in part on a NATO North Atlantic Council recommendation issued to member nations for the adoption of priorities and allocations plans and procedures to ensure Alliance-wide industrial base cooperation to meet critical and urgent member nation defense requirements. In addition, SIES represented the Department and participated with representatives from other U.S. departments and agencies in CMX 98, the annual NATO-sponsored Civil-Military Exercise to test and exercise civil emergency preparedness of NATO nations to support both military and catastrophic natural disaster requirements.

During Fiscal Year 1998, SIES continued to participate in the development of a NOAA-led budget initiative for Fiscal Year 2000 to establish a strategic framework for Department of Commerce leadership in reducing the economic cost and social impact of natural disasters. Other Commerce agencies involved in this initiative are the Bureau of Economic Analysis, the Economic Development Administration, the National Institute of Standards and Technology, and International Trade Administration. BXA's contribution to the initiative includes: (1) using DPAS authority to ensure timely industrial base response for the repair or replacement of damaged or destroyed facilities, and the acquisition of urgently required natural disaster reduction equipment; (2) licensing exports of controlled natural disaster reduction equipment and technologies; and (3) working with other agencies and industry to promote the expansion of U.S. global market share for this equipment and technology.

Foreign Availability Assessments

Foreign availability assessments identify Year foreign sources of specific items subject to U.S. national security export controls and evaluate whether such items are of comparable quality and are available from foreign sources in sufficient quantities to render ineffective either the continuation of U.S. export controls on the items or the denial of an export license for the items. There are two types of foreign availability assessments: (1) denied license assessments and (2) decontrol assessments. The purpose of a denied license assessment is to determine whether a specific export license application should be approved on the grounds of foreign availability, while a decontrol assessment addresses the issue of whether U.S. national security export controls on specific items should be removed because foreign availability exists for such items.

SIES is responsible for reviewing foreign availability submissions and conducting foreign availability assessments. There were no foreign availability submissions received during Fiscal Year 1998. However, SIES will receive and review any properly prepared foreign availability submission and will initiate an assessment when there is sufficient evidence to support the belief that foreign availability exists.

Foreign Investment

Section 5021, the "Exon-Florio" provision, of the Omnibus Trade and Competitiveness Act of

1988 (which amended Section 721 of the Defense Production Act of 1950) provides authority for the President to review the effects on national security of certain mergers, acquisitions, and takeovers of U.S. companies by foreign interests.

The interagency Committee on Foreign Investment in the United States (CFIUS) and the Treasury Department have authority to implement the law in consultation with other CFIUS members. SIES represents BXA on the CFIUS. The law provides a framework for a maximum 90-day review of foreign transactions. This period includes 30 days to determine whether to investigate a transaction, 45 days to complete an investigation, and a final 15 days for the President to act.

SIES conducts Exon-Florio national security reviews in coordination with other relevant offices within the Department. In Fiscal Year 1998, the Department reviewed 61 investment notifications; no cases went to the 45-day investigation period. SIES, as a participant in CFIUS, works to ensure that the U.S. defense industrial base will not be compromised by foreign acquisitions. This is consistent both with the confines of the law and the Administration's open investment policy.

International Diversification and Defense Market Assessments

SIES developed this program to assist small and medium-sized U.S. companies in their efforts to diversify and/or expand into overseas commercial and defense markets. The program is structured to provide current market information for dual-use and defense products and is implemented through publication of a series of international diversification and defense market assessment guides. These guides provide information to U.S. manufacturers regarding dual-use and defense markets in specific regions: Europe; the Middle East; the Pacific Rim; and the Western Hemisphere. Each chapter within the guides provides comprehensive information on how to do business in a specific country. This information includes details on specific upcoming commercial and defense trade opportunities open to U.S. firms in these markets, as well as a listing of key points of contact, both in the United States and in the host country, who can provide additional information and assistance to U.S. firms.

In Fiscal Year 1998, BXA added its second editions of the Pacific Rim Guide and the European Guide to BXA's Internet website to increase access by small and medium size companies. Updates of all the editions, including the Middle East and Western Hemisphere Guides are planned for Fiscal Year 1999. These guides are available in printed format as well as electronically through the BXA Internet website and the Department's National Trade Data Bank (NTDB).

National Defense Stockpile

The National Defense Stockpile, managed by DOD under the authority of the Strategic and Critical Materials Stockpiling Act of 1979, as amended (Stockpiling Act), is a \$5.4 billion holding

of strategic and critical materials which are unavailable in the United States in sufficient quantities to meet anticipated national security emergency requirements. SIES provides Department of Commerce input into policy development and ongoing operation of the National Defense Stockpile, including acquisition, disposal, and storage of stockpiled materials.

SIES (for the Department) and the Department of State Co-chair the Stockpile Interagency Market Impact Committee (MIC), which was established by the Fiscal Year 1993 National Defense Authorization Act (NDAA) to provide expert interagency advice to DOD on Stockpile acquisitions and disposals. This advice helps DOD to meet its statutory obligation to avoid undue market impact while protecting the government from avoidable loss. SIES, along with the other MIC members, also encourages DOD to adopt innovative marketing programs designed to maximize the return on Stockpile material sales to the Government while minimizing the effects of these sales on both domestic and global markets. In view of continuing Congressional interest in disposing of an increasing quantity of excess Stockpile materials, the MIC now meets semi-annually to review DOD Stockpile sales and market conditions to ensure that proposed sales will not and do not cause undue market impact. Additional meetings are scheduled as needed to deal with urgent issues.

The Fiscal Year 1993 NDAA also directs the MIC to “consult from time to time with representatives of producers, processors and consumers of the type of materials stored in the stockpile.” Accordingly, under SIES leadership, it is MIC policy to seek as much public input as possible to the MIC review of DOD’s proposed Annual Material Plan (AMP) for disposal of excess Stockpile materials. Furthermore, since publication for the first time of material disposal quantities as part of the proposed Fiscal Year 1997 AMP deliberations, SIES has received a significant increase in the number of public comments on the materials. This action has made the MIC review process more transparent and enables the public to assess more effectively and efficiently how proposed disposals will impact their business or industry. The AMP material quantities are now published as standard procedure with all proposed AMPs by SIES in both the Federal Register and an accompanying press release.

In Fiscal Year 1998, the MIC was concerned with depressed prices in several major commodity markets and encouraged DOD to limit proposed stockpile sales of these commodities. Also in Fiscal Year 1998, in response to the growing concern over the availability of adequate supplies of titanium for both defense and commercial aerospace use, SIES staff completed a comprehensive review of the status of the titanium industry and its ability to achieve timely deliveries of titanium products. The study found that because of the expansion of industry capacity coupled with the cancellation of commercial aircraft orders, titanium delivery lead times are shrinking and will not pose a threat to such programs as the Air Force F-22 fighter and development of the multi-service Joint Strike Fighter.

Offsets in Defense Trade

During Fiscal Year 1998, SIES prepared its third annual report to Congress on offsets in

defense trade. This annual report is required by the 1992 amendments to Section 309 of the Defense Production Act of 1950. This year's report builds upon data collected in previous years, adding 1996 offsets data reported by U.S. firms in the last year. This report covers the period 1993-1996.

Offsets are the practice by which the award of U.S. contracts by foreign governments or companies is exchanged for commitments to fulfill the contract with some form of industrial compensation, which could include, for example, requirements such as domestic production content, technology transfer, or foreign investment. Virtually all U.S. defense trading partners impose some type of offset requirement, and at times the stated value of the offset exceeds that of the sales contract. The type of offsets demanded by buyer countries is changing as many countries face decreasing security threats and excess capacity in their arms industries. Countries require offsets to ease the economic burden of large defense purchases, to increase or preserve domestic employment, to obtain technology, and/or to promote targeted industrial sectors.

Between 1993 and 1996, 32 U.S. companies entered into 173 new offset agreements with foreign governments valued at \$15.1 billion, with an average completion term of 87 months. The agreements supported \$29.1 billion in defense contracts. The new agreements were concluded with 28 countries.

In addition to entering into new offset agreements, U.S. companies also carried out transactions in accordance with agreements reached in previous years. During the four-year period, 34 U.S. companies reported 2,277 individual offset transactions valued at \$9.2 billion, for which they secured offset credits valued at \$10.7 billion. Transactions were completed in 31 countries, with the top five countries accounting for 58 percent of the value.

Seventy-three percent of the transactions' value was composed of subcontracting activity, purchases (counter trade), or technology transfer. Nearly half the offset transactions were related to transportation equipment (including aircraft and aircraft parts), 16 percent of the transactions were in the electronics and electrical equipment sector, and nine percent in industrial machinery.

Direct offset transactions rose to about 43 percent in 1996, up from the 40 percent recorded in the previous year. This continues the upward trend in direct offsets. The trend reflects very substantial increases in subcontractor activity in the United Kingdom and a very large jump in technology transfers to South Korea. The large increase in subcontractor activity was moderated somewhat by decreases in Israel, Canada, and Australia.

Europe continues as the leading region engaged in offsets. In the four reporting years, European countries entered into 94 new offset agreements with U.S. firms valued at more than \$10 billion, with an average offset equaling 90 percent of the export contract value. In the last two years of the reporting period, European countries alone accounted for 85 percent of the value of all new offset agreements; the value of European offsets averaged more than 100 percent of the value of the export contracts. The rest of the world, with an average offset agreement equal to

only 28 percent of the export contract, accounted for \$5 billion in offsets.

During Fiscal Year 1998, SIES continued its efforts to support a long-defined U.S. Government goal to engage U.S. trading partners in a dialogue to limit the adverse impacts of offsets. As the first step in this effort, SIES, with the support of the interagency community, organized and hosted a series of meetings with interested parties -- prime contractors, subcontractors, government agencies, and labor representatives -- to solicit views on offsets. These meetings are a necessary precursor to formal discussions with U.S. allies:

- October 22, 1997 - BXA Under Secretary Reinsch briefed 21 foreign defense attaches' assigned to embassies in the United States.
 - January 13, 1998 - SIES hosted an Industry-Government Forum on Offsets with a focus on U.S. defense prime contractors.
 - January 14, 1998 - SIES co-sponsored a two-day "Symposium on Trends and Challenges on Aerospace Offsets," hosted by the National Research Council.
 - February 5, 1998 - SIES and the Department of Labor co-hosted a forum on offsets with the focus on U.S. labor and related organizations.
 - April 1, 1998 - SIES hosted a one-day session, "The Effect of Offsets on the U.S. Subcontractor Base," in Austin, Texas. The objective of the meeting was to gather the offset experiences and viewpoints of the small- and medium-size businesses and associations that make up the second and third tiers of the U.S. defense industrial base.
- C May 18, 1998 - BXA Under Secretary Reinsch spoke about offsets in defense trade before an audience of European industry and government officials at "Bridging the Transatlantic Technology Gap: The Future of NATO Defense Technology Exchange," in London, England.

Based on the positive results from the sessions held with various players in the offsets community, SIES and the interagency team are focusing efforts on identifying the most appropriate forum to initiate consultations with our allies on offsets.