PLI Export Administration Keynote Address

December 8, 2008

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Thanks very much. Having chaired this conference for many years, it's a particular pleasure to address you from my current vantage point. Thanks to Peter for stepping in on short notice to help chair the conference this year and to Evan, as always. I hope he never retires.

It's been a privilege for me to serve as Assistant Secretary of Commerce for Export Administration, carrying forward to completion a number of reform initiatives of the Bush Administration and helping to position issues to be addressed by the incoming Obama Administration. My past experience in the private sector has certainly informed my recent work. Service in the government has provided a vantage point from which I have been able to make some overarching observations.

At the Update Conference a few months ago and in talks to various industry groups since, I've outlined the direction in which I intended to guide Export Administration within the Bureau of Industry and Security. Now, closer to the end of the Administration, it is possible to look back a little and take stock of what we have done, and to look a little farther into the future.

Today's Threats and the Global Economy

A fundamental purpose of our work has been, very simply, to modernize U.S. export controls to address the threats we now face and the realities of the global marketplace. This has taken place within the constraints of the existing, and I would say antiquated, statutory and regulatory system.

Of course, the threats today are vastly different from those that existed 50 years ago when our current system of sanctions and export controls was largely established. The global economy is vastly different as well.

The greatest threat today is terrorism. With a few important exceptions such as Iran, non-state actors pose a more immediate danger than nation states. The events last week in Mumbai, like those of September 11, 2001, make this threat only too real.

In terms of technology, the greatest threat is the proliferation of weapons of mass destruction (WMD), including nuclear and missile technology and chemical and biological weapons and their precursors. The risk is not limited to high technology; even basic electronic components can be used for destructive purposes. But putting these two together – WMD in the hands of non-state actor terrorists – poses the greatest threat of all.

These threats exist in a global economy in which national borders are increasingly porous. Advances in logistics have facilitated the shipment of goods;

multinational enterprises provide services worldwide; people relocate with relative ease taking skills and know-how with them; and vast amounts of data can be sent anywhere with the click of a computer mouse. Companies are establishing research and development facilities – not just production, marketing and sales functions – in countries such as China and India. Technology that is so prevalent today that we take it for granted could hardly have been imagined 50 years ago, and the pace of change is accelerating.

The U.S. Export Administration Regulations have not adapted well to these changes. Since the 1980's, the regulations have been reorganized and renumbered, the Commerce Control List (CCL) has been updated incrementally, and country policies have evolved. The structure of the controls, however, has remained the same. Even changes that seemed significant when they were made in the mid-1990's are now out of date. Encryption, for example, was a novel, cutting edge technology then, but it is now routinely integrated into a wide range of products and the software is readily available worldwide.

A particularly difficult issue for the U.S. regulatory system to address – another reality of today's global economy – is the migration of civilian technology to military applications and vice versa. The defense establishment seeks to reduce costs by purchasing commercial off the shelf (COTS) items and encouraging interoperability among our allies. At the same time, items originally developed for

the military are being used in commercial applications with minor modifications, such as head-up displays, counter manpads, night vision equipment and aircraft components. Treating items that are "capable" of military uses even though they have not been "specifically designed" for that purpose potentially subjects a wide range of items to very strict controls under the International Traffic in Arms Regulations (ITAR). Far from promoting cooperation, subjecting minor incorporated content to ITAR controls prompts non-U.S. companies to design out U.S. content.

Export Control Reforms

Having worked in this area for so many years, I would be among the first to admit that the U.S. system is cumbersome and sometimes confusing, with three separate agencies each with its own statutory mandates and regulatory intricacies. The system would be more efficient, and perhaps more effective, if it was systematically re-designed and administered by a single agency or independent body, as is the case in most other countries. Realistically, I do not think such a unitary approach to the administration of export controls is likely to happen. Instead, I would expect to see a process of grafting improvements onto the existing system in a way that improves interagency cooperation and adapts the system in a step-by-step fashion to address these current threats and the realities of the global economy.

This is a process that has, in fact, already begun. The January 2008 Presidential export control reform directives signaled a shift in export controls away from a country- and technology-based system to one that targets more precisely the threats we now face. This shift continued a process that began after the end of the Cold War with the Enhanced Proliferation Control Initiative (EPCI) and its focus on end-uses and end-uses of WMD-related products and technology. The export control reform directives also addressed technological innovation and the critical importance of keeping export controls up to date with the rapid pace of change.

Trusted Exporters and Recipients

U.S. dual-use export control policy needs to focus even more on end-uses and end-users. At BIS, we look at these in both a positive and negative sense – positive in the sense of trusted exporters and recipients of products and technology, and negative in the sense of individuals and entities acting against U.S. national security and foreign policy interests.

An example is the new intra-company transfer (ICT) license exception that was recently published as a proposed regulation. This license exception will authorize companies with effective internal compliance systems to ship within their corporate families a wide range of products and technology for their internal

use. This should greatly simplify licensing for companies with global R&D and manufacturing operations.

A number of comments have been received, generally favoring ICT but raising questions about administrative burdens and eligibility. I appreciate that companies would like eligibility to be essentially automatic for certain technologies like License Exception ENC, or would like the U.S. Government to simply accept their word that they have effective internal compliance systems. Neither approach is realistic. In an end-user based system, lighter government regulation must go hand in hand with demonstrated compliance. In finalizing the ICT regulation, the principal issue that will have to be addressed is how compliance should be demonstrated by companies and how it should be evaluated by government agencies in a way that does not impose unnecessary burdens while still providing a significant regulatory benefit.

The Validated End User (VEU) program for China and India also embodies this positive approach. VEU is available for approved recipients of controlled U.S. products and technology in these countries. VEU is potentially available for other countries as well.

The negative side of the end-use/end-user equation is also important. We recently published a new Entity List regulation that sets out in one place the criteria for designation or removal from the list and we consolidated entities that

had been listed in other parts of the regulations. The Entity List provides a new, more flexible tool to use in establishing a licensing requirement for products or technology that otherwise would not be controlled for entities that have been found, based on specific and articulable facts, to be acting contrary to the national security or foreign policy interests of the United States. Hundreds of names have already been added to the list. Also important, there is a process for removing entities from the list as well.

Technological Innovation

It is essential to keep the CCL up to date. BIS has instituted a program to review the entire CCL over a three year cycle, and we recently published regulations implementing Wassenaar Arrangement 2007 changes to the CCL and changes to unilateral CCL controls. We are working on proposals for Wassenaar 2008. I hope it will be possible to publish these changes within a few months of their adoption in the first quarter or early second quarter of 2009.

BIS published another regulation that addressed *de minimis* requirements for U.S. reexports, specifically the requirement to make separate calculations for hardware and software incorporated in foreign manufactured end products. Today, products are often manufactured with embedded software. It is impossible to disentangle the value of each and unrealistic to control the two separately.

Regulatory reform of controls on encryption items has been a priority. This issue has proved difficult both because of the rapidly expanding use of encryption as well as the highly sensitive nature of the technology. Consequently, the work has progressed in stages. We recently published an interim final rule that streamlined the requirements of License Exception ENC and made a few other changes. As I have indicated before, this is not a fundamental reform, but it is a start. A more comprehensive approach to encryption reform will take time, and we are already beginning that process.

The overhaul of deemed export policy has also been a major focus of our work. This has been a particular interest of mine.

As you will recall, the Deemed Export Advisory Committee (DEAC), which grew out of a 2004 Inspector General Report and a 2005 BIS Notice of Inquiry, conducted an extensive study and issued a thoughtful report at the end of last year. In a nutshell, the DEAC report recommended that any regulation that controls deemed exports, i.e., transfers of technology to foreign nationals in the United States, must be crafted so that it targets only those individuals who would do us harm and controls only those technologies where there is the greatest risk. At the same time, export controls must not stifle the depth and diversity of research that takes place in our universities, federal laboratories and corporations, at the risk of harming our national security for years to come.

In response to the DEAC's recommendations, BIS established a new Emerging Technologies and Research Technical Advisory Committee (ETRAC) to advise on regulatory reforms dealing with deemed exports and related issues. The 24 ETRAC members, representing research universities, federal laboratories and industry, are all extraordinarily accomplished in their respective fields. The ETRAC will focus on such issues as a "zero based" review of the CCL to determine whether certain technologies currently on the CCL should be excluded from the application of the deemed export rules and how best to determine foreign nationality.

Commodity Jurisdiction Issues

As I mentioned, one of the realities of today's global economy is that commercial products and technologies may have military applications and military products may have commercial applications. The Export Administration Act and the Arms Export Control Act establish different statutory and regulatory frameworks that overlap in certain areas. This overlap presents a challenge for those at Commerce and State who implement the applicable regulations, as well as companies that must comply with them.

In the aerospace area, jurisdictional issues have been addressed to a large extent by the State Department's issuance of a clarification of the standards it will use in applying Section 17(c) of the Export Administration Act in the context of

the International Traffic in Arms Regulations (ITAR). We have just published a clarification of the EAR in a further effort to harmonize the overlapping EAR and ITAR provisions.

Similarly, we are in the process of addressing with our DOD, State and National Security Council colleagues commodity jurisdiction issues dealing with night vision equipment, and we hope to finalize a regulation on this issue in the next few weeks. This issue is especially difficult because many of these products were designed exclusively for civil applications but some could be diverted to uses contrary to our interests, including against our forces in combat. The consequences of over-regulation are serious because subjecting all such products to ITAR jurisdiction will reduce R&D by U.S. companies and limit their ability to export. Comparable quality equipment is also available from foreign sources. In part to address this issue, we recently initiated a Foreign Availability Assessment under EAR Part 768 in response to a TAC submission. This is a path-breaking exercise. It is the first such assessment conducted in the last 14 years.

Regulatory and International Cooperation

These export control reforms have been taking place in a bureaucratic environment in which the various agencies with responsibility for specific aspects of the system are generally working together in a cooperative fashion. In the enforcement area, Justice has created a separate division to prosecute export

control violations. DHS, with its Customs and Border Protection (CBP) and Immigration and Customs Enforcement (ICE) units, works with Commerce Department Export Enforcement agents and U.S. Attorneys' offices to investigate cases. A prime example of such cooperation is the recent Mayrow indictment targeting entities involved in illegally exporting/reexporting items through third-country front companies to produce IED's used against our troops in Iraq.

Transshipment is an issue of great concern, which Commerce and State have been cooperating to address, with encouraging results in a number of countries.

It is interesting that these developments have been taking place in an international environment in which there has been remarkably little friction between the United States and other countries over extraterritoriality, as was prevalent in the 1980's (with the Yamal pipeline controversy) and 1990's (with the Helms-Burton and ILSA controversies).

Members of multilateral export control regimes share information and control the same technologies because there is a common security interest in making sure these items do not get into the wrong hands. Nearly three quarters of the CCL consists of multilaterally controlled items.

Non-regime countries are also adopting export controls, as required by U.N. Security Council Resolution 1540 (2004). And under the Proliferation Security Initiative (PSI), partner states have agreed to cooperate to stop shipments of WMD,

their delivery systems and related materials from flowing to or from other states or non-state actors of proliferation concern.

There is particular recognition of the threat posed by a nuclear Iran, and U.N. Security Council Resolutions have provided the framework for countries to adopt sanctions that are broadly consistent with, though not as extensive as, those implemented by the United States. The veiled (and sometimes not so veiled) threat of U.S. enforcement action has prompted foreign financial institutions to avoid doing business with Iran, achieving voluntarily a result that would have been criticized a few decades ago as encroaching on other countries' sovereignty. The recent revocation of the U-turn exemption in the Iranian Transactions Regulations will further isolate Iran from the U.S. and global financial system.

I have convened an inter-agency working group, which meets regularly to share intelligence and coordinate the development and implementation of initiatives to deal with the danger posed by Iran's nuclear program. At BIS, we expect to publish before the end of the year a regulation that will address aircraft parts and other issues.

Future Prospects for Reform

This cooperation is certainly positive but further reforms could make sanctions and export controls more effective U.S. foreign policy tools. Their effectiveness would be significantly enhanced by the enactment of permanent

enforcement authority. Strong enforcement is an essential element of effective regulation. Congress considered such a bill this year, which could be revived next year.

We need a new Export Administration Act. Reauthorizing the expired EAA in its current form is not an option. It is necessary to re-think its basic purpose and bring it into line with today's threats and the realities of the global economy. This will not be easy. As you know, a number of attempts have failed in the last decades, not so much because of partisan politics but rather disagreements within political parties over how to strike the right balance between protecting our security while freeing international commerce from burdensome over-regulation.

In 1991, a National Academy of Sciences study paved the way for the transformation of export controls from a COCOM-based system to the current regime-based system. The NAS, a well-regarded think tank, or perhaps a bipartisan congressional committee should undertake a study today. Such a study would provide the intellectual framework for a new export control system that would, among other things, integrate elements of other U.S. export controls dealing with financial sanctions and arms exports, along with dual-use technology exports, into a more coherent whole.

Of course, the election changed the political landscape. Perhaps it may be possible to undertake such a study in a spirit of bipartisanship. Sanctions and

export controls are not political issues and did not figure at all in the campaign, and they are by no means the highest priority when weighed against such issues as the financial markets crisis and the global economic downturn. But they do relate to these larger issues. International trade has historically been an engine of economic growth. Focusing export controls on today's real threats and working with other countries to promote secure trade will permit lighter restrictions on less sensitive high technology exports, which will help fuel the growth we need.

Eventually, export control reform will have to be addressed. The same forces that have shaped the reforms we are implementing now will still be present after Inauguration Day. The next Administration will have to deal with the same issues – strengthening sanctions on Iran, addressing China's desire to expand high tech trade while guarding against its military modernization, reviewing export controls on India in the aftermath of the civil nuclear agreement, and encryption reform, among others. In any transition, some delay is inevitable as the new Administration reassess policy and new individuals are nominated and confirmed. If companies and industry coalitions want to maintain the momentum behind export control reform, they should make their views known early and often at the highest levels.