



Statement

of The Honorable John Engler
President, National Association of Manufacturers

on behalf of the National Association of Manufacturers

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

on **“Export Controls: Are We Protecting Security and Facilitating
Exports?”**

July 26, 2007

**MANUFACTURING
MAKES AMERICA STRONG**



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The Honorable John Engler
President and CEO, National Association of Manufacturers
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For the Hearing
Of the
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Chairman Sherman, Ranking Member Royce and Members of the Subcommittee:

I appreciate the opportunity to submit this written statement to the subcommittee on behalf of the National Association of Manufacturers (NAM). The 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 military equipment and technology to our armed forces. A much larger group plays a key support role, supplying the advanced industrial technology, machinery and information systems that ensure our defense industries and military have the capabilities they need to defend the nation.

America's high-technology industries are important not only for defending our nation but also for supporting a strong and growing economy. Companies in this sector employ over 4 million workers, most of whom receive wages much higher than the national average. High-technology industries are also the nation's largest exporter. In 2006, high-technology exports represented 37 percent of total U.S. manufactured goods exports or \$345 billion. As manufacturing in the United States continues to evolve, we will depend increasingly on these high-technology industries to expand exports, create jobs and keep our economy strong and competitive.

For all these reasons, the NAM has taken a strong interest in export controls and how they affect the manufacturing sector. In March, the NAM worked with several other leading business organizations to form the Coalition for Security and Competitiveness, with the goal of modernizing and improving the export licensing system for both dual-use and Munitions List items. My submission to the subcommittee, however, will focus primarily on the importance of modernizing the State Department process and the impact this will have on manufacturers' ability to support our national defense.

The subcommittee's hearing on export controls and their effectiveness in protecting security and facilitating exports could not be more timely. The United States faces new—and in many ways more challenging—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 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. Yet the export control system will not serve the country's security needs unless it also helps to sustain a dynamic, innovative and globally competitive manufacturing sector that can actively engage in international trade and leverage the talent and technical resources of foreign partners. The current export control system makes it increasingly difficult to do this. Over time, we fear that the burdens of the export licensing process will erode America's global technology leadership and overall industrial competitiveness, hurting both long-term U.S. security and economic interests.

The current system is a relic of a different era when technology evolved more slowly, the United States dominated high-technology industries, and U.S. companies concentrated their manufacturing and R&D in U.S. facilities. That is all changed in this new era of globalization. Technology life cycles, for example in computers and software, are measured in months, not years. The United States faces intense competition in high-technology sectors not only from Europe and Japan but also newly industrializing economies, such as South Korea, Taiwan and China. And increasingly the development of new technology and advanced products occurs through international collaboration, either through a network of company manufacturing and R&D facilities around the world or partnerships with foreign companies that can bring unique technical resources and talent to a project.

Globalization, then, has profoundly changed the world of manufacturing and the way U.S. businesses operate today. It has also had a powerful effect on the U.S. defense industry. Simply put, the export control system has not kept pace with globalization. The preliminary findings of the 2007 Defense Science Board Report state that the "current [export control system is] not enabling an effective, agile, and affordable joint military force for 21st century needs."

Globalization has also brought a much higher level of interdependence than in the past. At a recent conference on export controls sponsored by the Atlantic Council, Dr. Jacques Gansler, the Under Secretary of Defense from 1997 to 2001, stated: "There's not a single weapon system today that you can take apart and not find foreign parts in it. We are dependent. We are not necessarily vulnerable, though." Dr. Gansler also said that the current barriers to globalization in the defense export process are inhibiting effective, affordable and quick military response for U.S. security needs of the 21st century.

One of the principal concerns of U.S. industry about the current export controls system is that it does not effectively distinguish between items that are truly sensitive and those that are, in effect, commercial products widely available in the global marketplace. McGeorge Bundy, former National Security Advisor to presidents Kennedy and Johnson, perhaps said it best when he cautioned, "If you guard your toothbrushes and diamonds with equal zeal, you'll probably lose fewer toothbrushes and more diamonds."

Let me give an example of how the current system has gone awry. Now it turns out that because of the way "military" products are classified, aircraft toilet seats get

caught up in the export control system. The same toilet seat that goes into a commercial aircraft product is controlled by International Traffic in Arms Regulation (ITAR) if it is modified by a few inches and installed in a Munitions List item. The U.S. government shouldn't be wasting resources licensing toilet seats when there are more sensitive items that need careful monitoring and control.

Other kinds of controls are having more broad-ranging effects on the ability of civilian high-technology industries to support national defense. The Department of Defense, for example, acknowledges that many of DoD's newest systems can be developed and field tested more rapidly and cheaply in the civilian commercial sector. Commercial companies are finding inexpensive ways to modify equipment, technology and systems designed primarily for commercial use to the military environment, and they are looking at the DoD as a new growth market. This is especially true for the software and microelectronics sectors. Advanced chips developed for the commercial sector now form the backbone of advanced military systems. They are produced and available commercially around the world from non-defense companies.

But the current export system is increasingly at odds with the way companies today develop new cutting-edge technology through international collaboration. U.S. companies collaborating with their foreign subsidiaries, say in Europe, on new technology may be required to first obtain an export license for controlled technology to send an email, provide information over the telephone or transfer a product across the Atlantic to its European facility. European companies, however, are not constrained by the same restrictions. Similarly, American companies cannot give their foreign employees access to controlled information without first applying for a "deemed export" license even though the company controls how the information is used and usually has in place strict corporate-wide non-disclosure policies for its employees. These export licensing requirements raise the cost of technology development for U.S. companies and provide an incentive for businesses to conduct R&D on new technology outside the United States so they will not be subject to U.S. export controls.

Excessive controls have other adverse consequences as well. American companies are finding that potential customers are deliberately "designing out" U.S.-made components in their product to avoid U.S. export controls. European companies are already advertising their products as "ITAR-free". EADS (the European Airbus consortium), for example, is one of the companies that offers "ITAR-free" products.

One NAM member company recently lost a 20-year contract with a British company because of concerns about export controls. The British firm, while admitting that the American product was superior, indicated that it made a corporate decision not to allow U.S.-made products in its systems anymore because of the need to obtain a U.S. import license. Its customers in Asia (e.g., Taiwan, South Korea and Japan) and Europe had reportedly insisted on provisions in sales contracts that explicitly barred the use of U.S.-manufactured articles.

Our allies abroad are losing faith in the U.S. government to administer the export control system efficiently, and by default they are losing faith in American companies. We fear that in the coming years U.S. high-technology manufacturers will find themselves more and more isolated from the international marketplace and from the very innovation the United States needs to protect national security. We must not let this happen.

The NAM has endorsed the nineteen recommendations submitted to the President by the Coalition for Security and Competitiveness for improving the licensing process at the State and Commerce departments. Given the subcommittee's focus on State Department licenses at this hearing, I would like to highlight several problems that are particularly burdensome on manufacturers and in need of urgent attention.

First, the sheer number of license applications is overwhelming the process for authorizing exports at the State Department. An unprecedented 100,000 license applications are expected in 2007, according to a senior department official. This will inevitably lead to longer delays. Currently, processing applications takes from a low of 16 days to a high of two years. To help solve this problem, the coalition recommends alternative licensing procedures. In particular, an expanded and more flexible process for granting "program licenses" could go a long way to reducing the number of licenses while at the same time ensuring strong security safeguards. We believe that improvements in this area merit urgent attention.

Second, the lack of accurate interpretation and consistent use of the International Traffic in Arms Regulations (ITAR) has led to many commercial products being caught up in a lengthy and unpredictable "commodity jurisdiction" review in the State Department. Items determined to fall within the U.S. Munitions List are then subject to more stringent controls. Greater transparency and predictability in the commodity jurisdiction process and more accurate and consistent interpretation of ITAR would improve the efficiency of the system and likely reduce the number of transactions requiring State Department licenses. One way to advance that goal would be to designate the Commerce Department, which has more expertise in assessing the commercial applications of advanced technology, the lead agency for analyzing "predominant civil applications" and "commercial equivalence." We strongly endorse keeping FAA-certified equipment for commercial aircraft, a major manufacturing sector export, within the jurisdiction of the Commerce Department. We believe that Section 17(c) of the Export Administration Act (EAA), which was maintained in effect through the International Emergency Economic Powers Act (IEEPA), provides the authority to do this.

Third, the State Department's Directorate for Defense Trade Controls (DDTC) does not have adequate personnel and resources to efficiently process the large and growing number of license applications, which as previously noted are expected to reach record levels in 2007. I raised this issue personally with Deputy Secretary of State John Negroponte at a meeting earlier in the year. State Department officials acknowledge the problem. Industry estimates that an additional \$5 million would help DDTC to significantly improve its performance. We understand that some Members of Congress

are considering legislation to impose new licensing fees as a way of providing additional resources for DDTC. The NAM would have serious concerns about financing national security functions, such as the processing of licenses for Munitions List items, through a fee-based system. Industry already incurs considerable internal costs in processing licenses and maintaining an effective export compliance system. The burden is particularly heavy on small and medium manufacturers. Additional licensing costs are likely to discourage many small and medium companies from exporting military-related items and further disadvantage U.S. business in the global marketplace.

Finally, while the Senate has responsibility for treaties, I wanted you to know that the NAM supports the U.S.-UK Defense Trade Cooperation Treaty. We hope that the Senate will promptly approve it. The treaty offers an important opportunity to streamline the process for exchanging military technology, equipment and systems with our closest ally. It is exactly the right approach to managing sensitive technology: ease the burden on transferring controlled items to those individuals and companies in which we have high levels of trust and focus our limited government resources on other transactions of higher risk. Congress, the Administration and industry should work together to ensure that the implementing arrangements for the treaty protect national security, strengthen the U.S.-UK defense relationship and enable our companies to conduct business efficiently and without undue administrative burdens.

I commend Chairman Sherman and the subcommittee for taking the initiative in holding this hearing. Export controls on sensitive technology are essential for protecting national security. But we need a modern system that enables our manufacturers to continue to innovate, export and participate in the global marketplace. The current system is badly out of date and needs to be made more transparent, efficient and predictable. Improving the system will not only enhance national security but also ensure that American manufacturers maintain their technology leadership and competitiveness in the new global economy.