

Subcommittee on Agriculture, Energy and Trade

House Committee on Small Business

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Export Control Reform:
Challenges for Small Business?
Part I

Testimony of

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Mr. Chairman, I am very pleased to appear before you and your colleagues this morning to discuss the ongoing Export Control Reform, ECR, Initiative and its impact on small and medium sized enterprises, SMEs.

The Trade Compliance Group, formerly known as MK Technology, has been advising large corporations and SMEs regarding export control policies and procedures since 1986. We offer a comprehensive array of export compliance services and a broad range of compliance education and training services including custom training programs, instructional videos, and online export controls learning programs.

I am its Vice President and Managing Partner performing trade compliance assessments and developing compliance programs under the Bureau of Industry and Security Export Administration Regulations and the Directorate of Defense Trade Controls International Traffic in Arms Regulations. I have experience in both managing export control teams in many large companies and in advising scores of SMEs struggling to comply with a complex regulatory environment.

It is very much an open question as to the impact the ECR Initiative has had on SMEs. We don't have a definitive answer, but we would pose some questions that might lead Congress and the Obama Administration in the right direction. We also have some modest suggestions that would help to ensure that their interests and concerns are at the center of the ongoing reform process.

We would start by asking BIS and DDTC to survey SME exporters. Ask them which elements of the ECR Initiative have been beneficial and which have not been. Has it altered their plans to market their goods and services in certain markets and regions around the world? How should the ECR Initiative be altered to take into account their concerns? Are there any recent surveys conducted by companies or business associations on the potential impact of the reform effort on SME suppliers and vendors?

In 2010, the Milken Institute and the National Association of Manufacturers issued a study entitled, "Jobs for America: Investments and Policies for Economic Growth and Competitiveness" concluding that modernizing U.S. export controls could increase exports in high-value areas. By 2019, an enhanced regulatory environment could increase GDP by \$64 billion, create 160,000 manufacturing jobs, and heighten total employment by 340,000.

More than five years into the ECR Initiative, your Committee should ask the Milken Institute and the National Association of Manufacturers to revalidate their study's conclusions to see if we are still on track for the GDP and job growth projections.

In 2009, prior to the Administration's announced launch of the ECR Initiative, MK Technology, together with the Thales Corporation, released its "Best Practice Project for the Export of Controlled Material" based on interviews with corporate officials with export control responsibilities in large and small companies. Among its conclusions, it found that "Care should be taken to manage the small supplier relationship especially in light of the fact that some are not well equipped to handle their own export compliance responsibilities". As relevant today as it was then, this small supplier role needs close scrutiny with many large companies divesting themselves of any compliance advisory or training role for their suppliers and sub-contractors.

SMEs were/are widely seen as disproportionately disadvantaged by the export control system. SMEs could not then and cannot now afford a large compliance staff or a Washington liaison office. Consequently, the overwhelming majority have less access to government licensing authorities than those enjoyed by large companies. Long licensing times and opaque regulations are continuing concerns. Further, due to the significant increase in BIS classification requests and DDTC commodity jurisdictions, the cycle time for those services has now reached the point of irrelevance.

To deal with these concerns, BIS and DDTC (as well as the Treasury Department's Office of Foreign Assets Control) should set up a Working Group to determine how exporter services can be made more accessible, responsive and user-friendly to SMEs. Also, these agencies should take steps to ensure that licensing officers and other agency personnel are fully trained regarding all SME exporter issues.

To be sure much progress has been made in streamlining regulations and increasing the clarity and objectivity of the U.S. Munitions List, and for every commodity and related software and technology that has moved over from the USML to the Commerce Control List the exporter no longer has to be concerned about defense services, brokering, registration, and registration fees. Also he can now take advantage of a *de minimis* rule, a less burdensome direct product rule and no purchase order requirements. In short, there are some definite advantages derived from the ECR Initiative and the transfer of thousands of items from the USML and the CCL.

While the ECR Initiative has begun to meet the expectations of the exporting community more progress needs to be made, its specific impact on SMEs has not received the attention it deserves. At this stage in the review process, it is time for the relevant agencies and industry associations to conduct surveys on the impact of the ECR Initiative on SMEs. Are small businesses sharing in any related job growth?

With the laudable goal of improving the export control system, government agencies have asked a lot of our exporting community including the expenditures of thousands of man hours and millions of dollars for compliance with new classification designations. For many companies, including many SMEs, they have had to learn a whole new compliance language moving from the ITAR to the CCL. And classification processes, which have been heretofore essentially black and white, are now dependent upon end-use information that has traditionally not been relevant to classification, and for the SME, is now extremely difficult if not impossible for the exporter to obtain.

In some of the conferences I have attended and the training sessions I have conducted the pain of ECR is almost palpable.

What are the ways to promote the adoption of the regulatory changes required under the ECR Initiative? One approach BIS should consider is the creation of a 'compliant exporter of the year award' similar to the exporter of the year awards now in place across a number of industry groups. Why not target SMEs for recognition particularly in the high tech sectors intended to be the beneficiaries of the export control reform process?

BIS should also consider directing the Regulations and Procedures Technical Advisory Committee, RPTAC, to review the impact of the recent changes in the Export Administration Regulations resulting from the implementation of the ECR Initiative. The focus should be on SMEs addressing their export competitiveness and as well as any reduced propensity to export or manufacture ITAR items.

With SME participation, the RPTAC could also help to advise regulators in developing a new common set of standards where the two control lists, the Commerce Control List and the United States Munitions List, would be merged into one.

DDTC's counterpart to the TACs is the Defense Trade Advisory Committee, DTAG. It advises the Department in the regulation of defense trade helping to reduce unnecessary impediments to legitimate exports while supporting defense requirements of U.S. friends and allies. In January of 2014, the DTAG Export Control Reform Working Group issued a number of findings on the progress and the problems associated with the reform effort.

The advisory group members noted that significant time and company resources were/are being invested in the cost of transitioned items and in the overall implementation of the ECR Initiative. They focused on the direct costs tied to industry supply chains, procurement and engineering program in learning and complying with the new regulations including ongoing reclassification and jurisdictional changes. For example, a SME vendor of "minor components" may have tens of thousands of drawings previously subject to the ITAR. Post ECR, those

thousands of drawings must all be reviewed in light of the new definition of “specially designed”. Application of the “catch and release” process on tens of thousands of drawings is financially prohibitive and, in some cases, impossible if there is a gap in the original supply chain, leading to assumptions and guesswork.

And they reviewed the indirect costs as well that are tied to administering and establishing the processes to support the regulatory changes. Specifically, these included employing additional staff, diverting existing staff from other tasks, making changes in production processes, employing consultants or other sources of expertise to assist in the regulatory changes, and compiling and storing information required under new reporting requirements. They noted that the costs were substantial enough to as to negate lower unit costs and to blunt their competitive edge.

Among their other observations: trade compliance programs are typically understaffed across a wide spectrum of companies and many corporate officials have difficulty finding the time to read proposed rules particularly if they are not directly related to the company’s products and services. In sum, industry doesn’t have the luxury of not getting it right.

An expanded and more inclusive Defense Trade Advisory Group could make its own recommendations to ensure that there are adequate resources at DDTC for taking on new responsibilities, including the flexibility to use existing resources, without increasing any fees. Taking into account the views of the SMEs, the focus should be on fee mitigation. Currently, DDTC registration fees range from \$2,250 to \$2,750 depending on the number of license applications or requests for authorizations during a 12 month period. SMEs could be considered for some kind of fee remediation.

Both DDTC and BIS should create new SME-dedicated portals on their respective websites that would provide useful compliance information and templates geared to the needs of the small business exporter.

And DDTC and BIS should issue guidance on the changes needed in the Foreign Military Sales, FMS, Program to promote the objectives of the ECR Initiative. FMS activity remains under the jurisdiction of the Department of State; however, associated parts and components have been transitioned over to the jurisdiction of the Commerce Department. Guidance is needed as to the conflicting jurisdictional authorities and licenses are still required for the re-export or transfer of parts, components and related items related to decades-old aircraft such as the C-130. Many SME aircraft parts and components are being disadvantaged by the current licensing requirements.

Any progress in reducing the licensing burden and in simplifying forms and procedures will be especially welcomed by SMEs. In this regard DDTC and BIS need to establish a single entry portal and a single form for use with electronic interface

through which all license applications can be submitted and redirected to the appropriate agency. Further reductions need to be made in the number of licenses for items remaining on the U.S. Munitions List, particularly for those items being exported to U.S. allies and partners for the replacement or repair of parts and components supporting U.S. government activities abroad.

Thank you for your attention and I look forward to answering any questions you might have.