

**Testimony of Deputy Assistant Secretary of State for Defense Trade Controls Brian Nilsson
at the House Small Business Committee Hearing on Export Control Reform**

February 11, 2016

Good morning Chairman Chabot, Ranking Member Velasquez and members of the committee. I welcome the opportunity to speak with you today about the Administration's Export Control Reform (ECR) initiative. Export controls are a key tool in our national security and foreign policy toolkit yet they historically have not received the attention that they deserve largely because of their detailed, technical nature. The Administration's early and regular engagement with the Congress, and in particular this committee, since the beginning of the reform initiative helped us administer a transparent reform effort in which many companies, large and small, actively participated. This committee in particular helped us develop the partnership with the Small Business Administration that Assistant Secretary Wolf mentioned, so again let me thank you for your continued interest and support.

The U.S. Export Control System is distinct from many of our allies' in that we have had two licensing agencies, one for munitions items administered by the Department of State and the other for dual-use items administered by the Department of Commerce. This structure made sense when governments relied heavily on technology that was uniquely developed for military use. Generally, it took a significant amount of time for defense technologies to migrate into commercial use. By design and by the nature of their development, the commercial and defense technology realms did not intersect as much as they do today.

During this time the United States also was largely self-sufficient: we almost exclusively owned the technologies we needed to meet many of our defense needs and we procured enough for our own military to sustain a robust defense industrial base, both the prime contractors and the many small- and medium-sized businesses that supported them. The threats we faced were also more easily defined, with a largely bi-polar world. These realities were reflected in our export control laws and our implementing regulations, and they served us well.

But these realities have changed. The Berlin Wall came down; the Warsaw Pact was dissolved, closely followed by the end of the Soviet Union. Within a few years, the Pentagon started to procure more off-the-shelf commercial items. The threats we face today are more diffuse and often come not from nation states, but from non-state actors. Our export control system did not evolve sufficiently to meet these new threats.

At the beginning of the Administration's reform initiative in 2009, the Intelligence Community was tasked with assessing the current and anticipated threats facing the United States, to help inform our deliberations on what we should control and how. That assessment concluded that by 2025, virtually all next generation technologies would come from the commercial sector and then find their way into defense applications. That means an almost 100 percent reversal of the development trends that justified having two different export control systems.

As a result of these new realities, our separate systems increasingly collided, with similar items on both export control lists based on subjective design-intent criteria. This resulted in increased ambiguity, complexity, and costs to all involved. Large companies could afford Washington

lawyers to help them navigate the system; most small- and medium-sized firms could not. The clash was exacerbated by other fundamental changes: the United States no longer exclusively owns most technologies; many of our defense needs, both in developing systems and in fielding them, are done jointly with our allies; and we no longer procure enough ourselves to sufficiently sustain our industrial base to ensure our companies remain viable at all tiers of supply to meet new or future national security needs.

The cornerstone of the Administration's effort to address these changes has been to re-write the Department of State's United States Munitions List (USML), as the scope of the USML has the greatest impact on the regulated community and what we control drives all other aspects of the export control system. Prior to reform, the USML was a relatively short list of 21 categories of controlled items – like aircraft, helicopters, drones, and lighter-than-air aircraft –not based on specific technical parameters but on whether they were specifically designed, modified, or equipped for military purposes. This design-intent was also applied to all the parts, components, accessories, attachments, and associated equipment for these aircraft without enumeration. That meant we controlled military aircraft, as well as every nut, bolt, screw, windshield wiper, and seat belt buckle on that aircraft.

The aircraft category has typically constituted the largest number of export license applications we process every year, with over 22,000 export licenses in 2012, the last full year before our reforms began to take effect. Of these applications, about 76 percent were for these unidentified parts, components, accessories, attachments, and associated equipment, typically manufactured or supplied by small- and medium-sized businesses.

We have been engaged in a multi-year, labor-intensive technical review led by the Department of Defense to open each category of the USML and to enumerate those items that provide the United States with a critical military or intelligence advantage. Those less sensitive military items that do not meet this standard are being systemically moved to the Department of Commerce's jurisdiction to allow them to be exported to our allies under less rigorous requirements. This prioritization allows us to better focus our limited resources on the items, destinations, end-users, and end-uses of greatest concern, while improving interoperability with allies and bolstering our defense industrial base by allowing our parts and components manufacturers – many small- and medium-sized businesses – to more easily support systems we have already entrusted to our allies and partners.

In my aircraft example, I can report that since our new controls went into effect for this category and the gas turbine engine category in October 2013, we have seen an 83 percent reduction in license applications for parts, components, accessories, attachments, and associated equipment. That means that most of those companies making or supplying those items, may no longer need to register, pay annual registration fees of at least \$2,250, pay per-license application fees as may be required, no per-purchase order licensing requirements, no agreements licenses, and generally no "see through" rule that requires subsequent Department of State licenses for exports, re-exports, or re-transfers for their items incorporated into other items, until those other items' permanent importation into the United States or their ultimate destruction.

These reforms are only effective if we keep them current. Prior to ECR, the Department of State's control list was largely static. As a result of ECR and as part of our business practices going forward, the Department of State has fundamentally changed how we do business.

First, we can best keep our list current in partnership with all involved in the system – our interagency partners, the Congress, our allies, and industry. It is our companies, large and small, that are our front line of defense. They must be able to clearly understand and implement our rules, if they are to be effective, to provide for our collective security. We have put in place a process so they can advise us on proposed changes that we are contemplating, to tell us if we got it right and equally important, if we got it wrong. They can also advise us as technology evolves in their sectors, so we can make continuous improvements to our list.

Thus far, we have published proposed rules for 18 of our 21 categories. We received significant public input on which we relied in part to publish final rules revising 15 categories that have now gone into effect. As a result, the Department has seen a 56 percent reduction in licenses for these categories. By our most recent tally, based on the volume of license applications received, the largest categories are categories I (Firearms), XII (night vision equipment), XI (Military Electronics) and VIII (Aircraft)/XIX (Space and Missile), with approximately 10,000; 8,000; 8,000 and 7,000 licenses respectively. Of these, Categories I and XII have not yet been published in final form. The revised categories with the largest volumes are Military Electronics and Aircraft.

Of the remaining six categories, we have published three for public comment. Two of these three, for Category XII (night vision equipment) and for Category XIV (toxicological agents), are our most complicated, and for the night vision equipment category, we are finalizing a second proposed rule to publish for public comment, to ensure that we get it right. We will then turn to preparing final rules for the other two. This leaves three categories that cover firearms, large guns, and ammunition to publish for public comment. We plan to turn to these categories once we complete our work on the current three that are in process. The Department is working towards reviewing the remaining USML categories, and is committed to finalizing an initial review of the entire USML in 2016.

Going forward, we will routinely solicit public input on a category-by-category basis and, drawing upon our own interagency expertise and the public comments, will publish proposed rules to update each category. Earlier this week, on February 9, the Departments of State and Commerce published proposed rules of updated controls for the aircraft and gas turbine engine categories, with public comments due by March 25, 2016, and the public input period for four more categories concluded on December 6th, 2015.

We will continue this transparent process going forward. The Arms Export Control Act requires the President to conduct a periodic review of the list and to remove those items that no longer warrant control. This requirement is fully consistent with regulatory reform, one of this committee's top priorities. The President has also provided further guidance in Executive Order 13563 of 2011 on requirements for improving regulations and the regulatory review process.

Second, we are committed to continued enhanced engagement with the exporting community. All our notices, proposed rules, final rules, decision trees, and fact sheets are published on our website, as well as the Administration's central ECR site. We have also expanded our outreach efforts. In Fiscal Year 2015, we organized or participated in over 700 events, ranging from conferences and webinars to end-use monitoring checks and individual company visits. Our response team fielded over 19,000 phone calls and 22,000 e-mail inquiries. These actions were all done in addition to frequent meetings we hold with industry.

Third, we are changing how we manage our controls. Prior to ECR, each of the licensing agencies and the departments and agencies participating in the license application review process were all on independent information technology (IT) systems, or had no IT system at all. A key decision in phase one of the reform initiative was the selection of the secure Department of Defense internal licensing database, called “USXPORTS,” as the single licensing database. Moving to this system would ensure that each licensing agency has full information on what the United States Government has collectively approved or denied for export to ensure that current and future licensing decisions are fully informed ones. The Department of State moved to USXPORTS for processing munitions export license applications in July 2013 and for considering Department of Commerce export license applications in October 2015.

To aid industry, particularly small- and medium-sized companies, in compliance efforts, the Departments of State, Commerce, and the Treasury deployed a consolidated screening list comprised of all three departments’ various public screening lists that can be downloaded by exporters to self-screen parties to proposed transactions to facilitate compliance. When the initial list was deployed in December 2010, it contained over 24,000 line items of names, including variant spellings and pseudonyms, and was downloaded on average about 32,000 times per month. Since that time the Administration has deployed incremental improvements to this tool, including automated updates any time a department makes a change to one of its lists, a “fuzzy logic” search function, and new options for downloading for use with existing screening programs. The list is now being used to conduct more than 100,000 screens per day.

These improvements were prerequisites to building a single portal through which exporters can submit requests and receive licenses and other guidance documents. Preliminary work on a single portal in 2010 was placed on hold pending completion of the licensing agencies’ transition to USXPORTS. The development of the single portal has now resumed, with the goal of deploying a smart single interface through which exporters can submit all requests and the system will guide them through the process to correctly route the request to the appropriate licensing authority. This should be of particularly benefit to small- and medium-sized companies.

To support these significant changes, the Department of State last year created and filled a new Chief Information Officer position within the Directorate of Defense Trade Controls to oversee the Department of State’s collaboration with these IT projects and to undertake a comprehensive review to modernization all aspects of the organization’s work. This effort is underway and, when completed, the core aspects of our business will be fully automated. Implementing these modern business tools and practices is anticipated to significantly improve our administration of the munitions export controls.

Fourth, the Department of State will continue to provide foreign policy oversight of our export control system for all controlled items whether administered by the Department of State or Commerce. The export of less sensitive military items moved to Commerce jurisdiction will continue to be guided by all aspects of the Conventional Arms Transfer policy including human rights reviews. These changes will also not diminish the key role that the Department of Defense plays in considering exports to ensure they are consistent with our national security interests. ECR is not a decontrol of these less sensitive military items but a prioritization of how the Executive Branch mitigates risks. Export controls are about risk mitigation.

Export Control Reform has improved how the export control community inside and outside the government interact, allows us to prioritize our controls to better focus our resources of the threats that matter most, improve interoperability with allies, and bolster the health and competitiveness of the U.S. defense industrial base, particularly small- and medium-sized companies. ECR began as an initiative and is now a process. That process could best be administered going forward by the eventual consolidation into a single export control agency with a single control list. This is the logical conclusion of the initiative.

We look forward to continue working with Congress in administering our new export control system. I look forward to your questions. Thank you.