Export Control Reform:
Broad License Exemptions Increase Risks of U.S. Arms Reaching Iran;
Congressional Action Needed to Close Gaps

As part of its arms export control reform, the Obama Administration is planning to provide companies and individuals with many more opportunities to export U.S. arms with limited government oversight. The shift of tens of thousands of arms, including “significant military equipment,” from the State Department’s U.S. Munitions List (USML) to the Commerce Department’s Commerce Control List (CCL) will allow companies to use several types of license exemptions – i.e., to export without a license.

While the State Department’s USML has had some license exemptions for decades, those available on the CCL are much broader in scope and have fewer protections. ²

A review of government reports on previous use of license exemptions shows that Iran, China and Libya were able to exploit these exemptions via front companies to obtain U.S. weapons and spare parts. Increasing the use of exemptions increases the risk of unauthorized transfers and diversion, and it complicates the U.S. government’s ability to investigate and prosecute violations.

Congress must act to refine the administration’s arms export control reforms, to mitigate the increased risk of U.S. arms reaching Iran.

Illegal Diversion Routes Cited in U.S. Prosecution Cases from 2007 to 2009

Source: Government Accountability Office, 2010

¹ As examples, the administration plans to move these significant military items to the CCL: unarmed Black Hawk helicopters and older armored vehicles and unarmed amphibious vehicles.
² The CCL includes license exemptions for: Shipments of Lesser Value; Temporary Imports, Exports, Re-Exports and Transfer; Servicing and Replacement of Parts and Equipment; Technology and Software; Governments and International Organizations; and Strategic Trade Authorization.
Background: Exploitation of Licensing Loopholes

In an in-depth review of the State Department’s export license exemption for U.S. arms transfers to Canada, the Government Accountability Office (GAO) found in 2002 at least 15 examples in which entities used the exemption to divert or attempt to divert U.S. arms from Canada to another country, including China, Iraq, Iran, Libya, Malaysia, Pakistan or Sudan (see table).3 In three cases, Iranian and Chinese individuals established front companies in Canada to acquire and then illegally export the arms to Iran or China. In others, a Canadian entity illegally re-exported U.S. arms. Although it is unclear how many items were actually diverted, GAO reported last year that the Commerce Department found problems with 223 post-shipment checks it conducted from 2008-10 on unlicensed exports of CCL items to countries known for illegal arms diversions.4 In one example, U.S. officials discovered that U.S. electronic devices exported to Hong Kong were used in IEDs against U.S. troops in Iraq.

<table>
<thead>
<tr>
<th>Summary of Diversion Cases Using the Canadian License Exemption</th>
<th>Intended Destination</th>
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<tbody>
<tr>
<td>A Chinese national created a Canadian company that illicitly acquired a focal plane array-long-range infrared camera for China.</td>
<td>China</td>
</tr>
<tr>
<td>Individuals associated with Iranian intelligence created a front company in Canada and attempted to obtain USML controlled klystron tubes for Hawk missile systems. The U.S. government sought extradition of these individuals but was denied.</td>
<td>Iran</td>
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<tr>
<td>A U.S. company attempted to ship U.S.-origin military items to a subsidiary in Canada and then divert these items to Libya.</td>
<td>Libya</td>
</tr>
<tr>
<td>Fifty-eight M-113 armored vehicles were exported to Iran through Europe without U.S. government approval. The vehicles were originally exported to Canada’s armed forces.</td>
<td>Iran</td>
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Source: Government Accountability Office, 2002

In using the Canadian license exemption, the U.S. government found that companies and individuals exported prohibited arms and used brokers the State Department had identified as high risk, increasing the likelihood of diversion. During 2008-09, the State Department reported 25 examples in which entities may have used the Canadian exemption to export commodities—including missile component parts, aircraft engines and rocket launchers—explicitly prohibited for use with the Canadian exemption. According to a GAO report covering an earlier period, there have been a few cases in which exporters admitted to exporting arms prohibited for use with the Canadian exemption without State Department approval.6 If the State Department had a chance to review these exports, it would have denied them. Similarly, there have been at least nine cases in which companies used entities that were listed on the State Department’s Watch List, which includes many entities the State Department has determined require close scrutiny due to a heightened potential for diversion or other illegal activities.7

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6 GAO, “Lessons to be Learned from the Country Export Exemption.”
7 Ibid. U.S. Department of State, “End-Use Monitoring of Defense Articles and Defense Services FY 2009.”
The use of license exemptions has also made it much harder to detect and prosecute violations of arms export control laws. According to GAO, the key to demonstrating a violation of arms export laws is establishing criminal intent. But if no export license is required, government officials, including U.S. Customs, often do not have the paper work to establish intent. According to the Justice Department, license exemptions require greater foreign law enforcement cooperation to obtain necessary evidence. As a result, investigations into illegal activities are often more challenging and resource-intensive. With increasingly limited resources, officials frequently choose to investigate less challenging cases.

Compared to the State Department’s current USML license exemptions for arms exports to Australia, Canada and the United Kingdom, the CCL license exemptions are much broader in scope and have fewer protections. Companies exporting arms on the CCL will be able to use the new Strategic Trade Authorization (STA) license exemption, which allows arms exports to 36 countries (mostly NATO) without a license. According to U.S. prosecutions from 2007 to 2009, some of these 36 countries have been actual or attempted illegal diversion points for transfers of U.S. arms to Iran (see GAO graphic above). U.S. companies can also use the STA exemption to export several military items without a license that were previously considered too sensitive to be included in the USML-related UK and Australia license exemptions.

In addition to the STA license exemption, the administration plans to allow a smaller set of military parts and components considered to be less critical to U.S. security to be exported license-free to every country except China, Cuba, Iran, North Korea, Syria and Sudan. This list includes countries where UN Security Council-mandated arms embargoes or State Department USML prohibitions exist. Based on a review of U.S. prosecutions from 2007-13, Iran regularly seeks to obtain many military aircraft parts and components in this category.

Actions Needed

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8 If companies are no longer required to submit export license requests, the U.S. government has much less detail on the company’s exports. GAO, “Lessons to be Learned from the Country Export Exemption.”
9 Ibid.
10 For more details, see the Commerce Department’s fact sheet at http://export.gov/static/ECR%20Factsheet%204%20-%20STA%20v%202_Latest_eg_main_047475.pdf.
12 Examples include harbor entrance detection equipment, ground effect machines, certain concealment and detection devices, and metal embrittling agents. See Supplement No. 1 to Part 126 online at http://www.pmddtc.state.gov/treaties/documents/UK_Supp_No_1.pdf. To see the same items on the CCL, review the administration’s proposed and final rules related to the Export Control Reform Initiative, including the July 8, 2013 Federal Register on military vehicles, online at http://export.gov/ecr/.
13 Unless otherwise prohibited for regular commercial trade under the CCL, companies could export “.y” paragraph and EAR99 items to countries such as Belarus, Burma, Ivory Coast, Cyprus, DRC, Eritrea, Libya, Venezuela and Zimbabwe without a license.
14 See the U.S. Department of Justice’s “Export Enforcement Case Fact Sheet” at http://www.justice.gov/nsd/list-view.html as well as more details on the cases from Public Access to Court Electronic Records (PACER). As an example, in November 2009, the director of Monarch Aviation Pte Ltd. was sentenced to 46 months in prison for conspiring to illegally export U.S. military aircraft parts such as switch assemblies to Iran. Switch assemblies appear to be included in cockpit switches, which are specifically listed in the “.y” paragraph items for military aircraft.
As the Obama Administration continues to transfer arms from the USML to the CCL, Congress must take the following steps in order to minimize the likelihood that Iran and China will be able to take advantage of this opening to obtain U.S. military technology:

- Adopt a phased approach. Mandate that defense articles long-recognized as “significant military equipment” and related major components remain on the USML until the U.S. government has had sufficient time to assess the risks of the move of other USML items to the CCL. Mandate also that all items previously deemed too sensitive to be transferred under bilateral license exemptions for Canada, the United Kingdom and/or Australia stay on the USML;

- Add in protections. Stipulate in law that only entities that have been previously registered and validated may be part of transactions associated with CCL license exemptions;

- Prohibit export of arms moved to the CCL to countries under State Department and/or UN arms embargoes; and

- Require that companies provide details on the export of all types of arms to U.S. Customs prior to export. Increase resources and expertise of U.S. Customs so that they are better able to assess exports of arms being made under license exemptions. Require U.S. Customs’ use of State and Commerce Departments’ “Watch Lists” of individuals and companies that have previously run afoul of export regulations.