Congress of the United States

U.S. House of Representatives

Committee on Small Business

2361 Rayburn House Office Building
Washington, DC 20515-6315

Memorandum

To:	Members, Subcommittee on Agriculture, Energy and Trade
From:	Committee Staff
Date:	February 8, 2016
Re:	Hearing: "Export Control Reform: Challenges for Small Business? (Part I)"

On Wednesday, February 10, 2016 at 10:00 a.m., the Subcommittee on Agriculture, Energy and Trade of the Committee on Small Business will meet in Room 2360 of the Rayburn House Office Building to convene a hearing to examine the ongoing Export Control Reform Initiative (ECRI) and the implications for America's small business exporters. As the Committee has heard throughout the 114th Congress, small businesses when exporting. The first hearing of this two-part series will provide Members with an opportunity to hear directly from small businesses on the difficulties they encounter when navigating the export control system, as well as their firsthand perspectives on the current state of the ECRI.

I. Background on the United States Export Control System

Exports accounted for nearly $2.4 trillion and have more than doubled since 2003.[1] According to the United States International Trade Commission (ITC), those exports helped support nearly 10 million jobs, including about 4 million small business jobs.[2] Whether a business directly exports an end-use product, exports a component part, or works as a tertiary supplier to an exporting corporation, the export control system influences its operations and competitiveness. However, exporting products is a daunting task for small businesses due to the lack of resources and properly trained personnel.[3] The complex nature of the export control system only adds to the confusion and high cost of the export process for small businesses.[4]

The federal government controls exports of sensitive equipment, software, and technology to protect national security interests and meet foreign policy objectives.[5] The export control system fulfills these duties by

[1] ITC, SMALL AND MEDIUM-SIZED ENTERPRISES: CHARACTERISTICS AND PERFORMANCE xiv (2010), *available at* http://www.usitc.gov/publications/332/pub4189.pdf.
[2] *Id.*
[3] *SBA's Office of International Trade: Good for Business?: Hearing Before the Comm. on Small Business,* 114th Cong. (2016) (statement of Eileen Sanchez, Associate Administrator, Office of International Trade, United States Small Business Administration), *available at* http://smbiz.house.gov/uploadedfiles/final_sanchez_testimony_12-1-2016_house_small_business_committee.pdf.
[4] NATIONAL SMALL BUSINESS ASSOCIATION, 2013 SMALL BUSINESS EXPORTING SURVEY 7 (2013) [hereinafter NSBA Survey], *available at* http://www.nsba.biz/wp-content/uploads/2013/06/Exporting-Survey-2013.pdf.
[5] http://www.state.gov/strategictrade/overview/.

restricting the export of certain goods and services. The Department of State regulates goods or services that "provide a critical military or intelligence advantage such that it warrants control under this subchapter [International Traffic in Arms Regulations or ITAR]."[6] The Department of State's regulation is supplemented by that of the Department of Commerce which regulates "purely civilian items, items with both civil and military ... applications [so-called "dual use" items], and items that are exclusively used for military applications but that do not warrant control under ITAR."[7]

The Department of State's ITAR regulations operate by requiring exporters to obtain a license if the good or service is specified on the United States Munitions List (USML)[8] which contains 21 separate categories of goods and services that run to 35 pages in the Code of Federal Regulations.[9] For other goods or services, an exporter would have to turn to the Department of Commerce's Export Administration Regulations (EAR), 15 C.F.R. Parts 730-74.[10] The EAR has its own separate control list – the Commerce Control List (CCL), *id.* at Part 774 (which is 40 pages long).

II. Export Control Reform Initiative

Given the brief synopsis of the export control regime, it is little wonder that American businesses, both large and small, have a long history of contesting that the ITAR and EAR are too rigorous, inefficient, complex, redundant, and out-of-date. Some businesses believe that the controls erect present too many regulatory barriers to exports and put firms at a competitive disadvantage when entering the global marketplace. The United States Department of State concurred and observed that many foreign firms are seeking to replace United States items so those foreign entities do not have to deal with the munitions licensing system.[11] The Department of State noted that such reforms cannot undermine national security or other international obligations of the United States.[12]

Complaints from various entities regarding the export control system's inefficiency and overbearing regulatory reviews prompted government officials to conduct a comprehensive interagency review of the existing United States export control system "with the goal of strengthening national security and the competitiveness of key U.S. manufacturing and technology sectors."[13] This interagency review observed that it was "overly complicated, contained too many redundancies, and, in trying to protect too much, diminished the ability to focus efforts on the most critical national security priorities."[14] Therefore, the Administration established the ECRI with the goal of undertaking a broad transformation of the United States export control system to enhance national security.[15]

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[6] 22 C.F.R. § 120.3(b). The entirety of ITAR can be found in Subchapter M of Chapter 1 of Title 22 of the Code of Federal Regulations, 22 C.F.R. Parts 120-130. Congress vested the authority to regulate the export of these items with the President in the Arms Export Control Act, 22 U.S.C. §§ 2751-2799aa-2. The President redelegated this authority to the Secretary of State. 22 C.F.R. § 120.1(a).

[7] 15 C.F.R. § 730.3. The Department of Commerce exercises this authority pursuant to the Export Administration Act of 1979, Pub. L. No. 96-72, 93 Stat. 503 (codified, as amended at 50 U.S.C. app. §§ 2401-20).

[8] 22 C.F.R. § 120,5(a).

[9] *Id.* at §§ 121.1. The USML also contains a separate missile control annex, *id.* at § 121.16.

[10] The EAR consumes 540 pages of dense dual column prose in the Code of Federal Regulations, including a two-page decision tree for supposed ease of use by potential exporters.

[11] *Export Control Reform: The Agenda Ahead: Hearing Before the House Comm. on Foreign Affairs,* 113th Cong. (2013) (statement of Thomas Kelly at 2, Acting Assistant Secretary, Bureau of Political-Military Affairs, United States Department of State), *available at* http://docs.house.gov/meetings/FA/FA00/20130424/100744/HHRG-113-FA00-Wstate-KellyT-20130424.pdf.

[12] *Id.* at 4.

[13] http://www.export.gov/ecr/.

[14] *Id.*

[15] http://www.export.gov/ecr/.

ECRI has three phases. In Phases I and II, agencies were required to "reconcile various definitions, regulations, and policies for export controls…."[16] The final element of ECRI is Phase III which "will create a single control list, single licensing agency, unified information technology, and enforcement coordination center."[17]

III. Status of ECRI

The Department of Commerce reports that "eighteen of the twenty-one categories of the United States Munitions List have been revised and published for public comment, fifteen of which have been published as final rules".[18] ECRI also involves the movement of certain items from the USML to a revised CCL. The items on the new CCL are subject to policies that allow for streamlined exports of most items to foreign government end-users to 36 United States allies and the majority of the members of the four multilateral export control regimes.[19] The three categories of the USML still awaiting harmonization are firearms, guns, and ammunition.[20]

In 2010, President Obama signed Executive Order 13,558, which established an Export Enforcement Coordination Center (E2C2) comprised of several federal agencies.[21] The E2C2 "serves as the primary forum within the Federal Government for executive departments and agencies to coordinate and enhance their export control enforcement efforts and identify and resolve conflicts … involving violations of the U.S. export control laws." [22] The E2C2 coordinates actions among the Departments of State, Treasury, Defense, Justice, Commerce, Energy, Homeland Security, and the Office of the Director of National Intelligence.[23] The Center is housed and supported by the Department of Homeland Security.[24]

Despite the efforts at coordination, statutory enforcement of various export control laws are delegated to the Departments of Commerce, State and Treasury.[25] To rationalize these enforcement efforts (which presumably will reduce complexity of the system to exporters), the Administration expects to "request legislation that would consolidate some of the enforcement agencies and stand-up a new consolidated administrative enforcement unit comprising compliance and enforcement officials from Commerce and State in the Single Control Agency."[26] The Administration states "the reorganization is a logical conclusion to the reform initiative, is a common sense approach, and is good government, especially in this era of tightening budgets."[27]

IV. Importance of ECRI to Small Businesses

Small businesses make up a significant portion of America's exporting companies. The most recent data from the Bureau of the Census identified 301,923 exporters 2014 of which 295,063 were identified as small

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[16] *Id.*
[17] *Id.*
[18] http://www.export.gov/ecr/index.asp.
[19] *Id.*
[20] *Id.*
[21] 3 C.F.R. 271-72 (Nov. 9, 2010), *reprinted at* 75 Fed. Reg. 69,573 (Nov. 15, 2010).
[22] 3 C.F.R. at 272.
[23] *Id.* at 271.
[24] *Id.* at 272.
[25] UNITED STATES DEPT. OF COMMERCE, ECRI #5 at 1 (2015), *available at* http://www.export.gov/ecr/index.asp (fact sheet #5).
[26] *Id.* at 3. The legislation presumptively requires completion of Phase III of ECRI by establishing the single export control agency.
[27] *Id.*

businesses, which accounts for nearly 98 percent of all exporters.[28] The ITC calculated that small businesses who exported averaged a 37 percent revenue growth from 2005-2009 compared to a decline of seven percent for non-exporting firms.[29] Despite the fact that the majority of United States exporters are small businesses, small firms only comprise of 33 percent of the United States economy's exporting value.[30] Strikingly, the National Small Business Association (NSBA) found that 63% of small business participants who did not already export said that they would be interested in exporting but felt that the lack of information on the process is an obstacle for them.[31] The NSBA also found that 15 percent of exporters produce an exportable good or service that are on one, or both, of the USML and CCL.[32]

As the Committee has learned through previous hearings on trade related issues, small businesses face a variety of trade barriers that limit their ability to compete in the export market, including higher tariffs and anti-competitive technical standards. This is exacerbated by the federal government's complex regulatory controls embodied in various control lists overseen by different agencies that have their separate enforcement mechanisms. This requires small businesses to dedicate employees to navigate these complexities. . For example, some trade specialists recommend that small exporting companies designate a compliance officer to be responsible for customs related activities, laws, and procedures because the penalties can carry heavy financial burdens and inefficient processing times.[33] If small firms do not have employees with such skills or cannot afford to allocate an employee to these functions, it necessitates retention of outside experts that can help small firms comply with export control laws.

Even the federal government recognizes that this system imposes significant financial barriers to small business participation in the export market. In some cases, obtaining a license under ITAR can cost more than the item brings in revenue.[34] Moreover, firms must register with the Department of State (with concomitant costs) even if the firms have no intention of obtaining a license to export under ITAR.[35]

If fully implemented ECRI may provide relief to many businesses, particularly small firms involved in the production of aeronautical and astronautical equipment, military vehicles, marine vessels, satellites, and electronics.[36] For example, full implementation may transfer products from the USML to the CCL which will reduce costs since the Department of Commerce is prohibited from charging an annual registration or other fees.[37]

VI. Conclusion

The ECRI has made substantial changes to the United States Export Control System and many of the reform's changes are intended to better streamline the process for American businesses. Much of the progress made thus far has been met with broad approval from private industry; however, there is still room for improvement such as finishing the changes in the USML and CCL. Finally, implementation of Phase III is likely to require legislative action to create a single export control agency so that small firms only must learn the processes and

[28] UNITED STATES CENSUS BUREAU, PRELIMINARY PROFILE OF U.S. EXPORTING COMPANIES, 2014, at 1 (2015), *available at* http://www.census.gov/foreign-trade/Press-Release/edb/2014/index.html#fullp. The Census Bureau categorized as small business any firm with less than 500 employees.
[29] ITC Characteristics and Performance, *supra* note 1, at xi.
[30] https://www.sba.gov/sites/default/files/FAQ_March_2014_0.pdf.
[31] NSBA Survey, *supra* note 4 at 15.
[32] *Id.*
[33] LESLIE ALAN GLICK, NAVIGATING US CUSTOMS LAWS: WHAT YOU NEED TO KNOW 9 (2015)
[34] https://www.commerce.gov/news/blog/2014/07/five-things-small-businesses-should-know-about-export-control-reform
[35] *Id.*
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[37] *Id.* Since guns, firearms, and ammunition have not been reclassified between USML and CCL, small firms in these industries still must pay significant registration and licensing fees to the Department of State. *Id.*

procedures of one agency rather than the current multiplicity of agencies each with their own internal regulatory and enforcement regimes.