

October 27, 2006

U.S. Department of Commerce
Bureau of Industry and Security
Regulatory Policy Division
Room 2705
14th Street and Pennsylvania Avenue, NW
Washington, DC 20230

Attention: RIN 0694-AD75

RE: Comments on Proposed Rule - Revisions and Clarification of Export and Reexport Controls for the People's Republic of China (PRC); New Authorization Validated End-User

Dear Sir or Madam,

The Wisconsin Project on Nuclear Arms Control ("Project") submits the following comments in response to the Commerce Department's Bureau of Industry and Security's ("BIS's") July 6, 2006, Proposed Rule (71 Fed. Reg. 38313) setting forth Revisions and Clarification of Export and Reexport Controls for the People's Republic of China (PRC) and a New Authorization Validated End-User. The Project is a non-profit organization conducting outreach and public education to bolster the nonproliferation of mass destruction weapons and their means of delivery. For more than twenty years, the Project has pursued its mission by advocating for strong and effective export controls worldwide. The Project commends the Commerce Department for the step it has taken in the direction of controlling sensitive American exports to China by publishing this proposed rule. It is not in the interest of the United States to allow its products to help China build up its military strength. There are two separate initiatives introduced in the rule; they deserve to be considered individually. Unfortunately, both initiatives have serious problems which are discussed below. We recommend that the proposed rule be withdrawn for further consideration by the Department.

PRC Military End-use License Requirement

The proposal would require a license for the export of certain listed items to China if the exporter "knows" that item is intended for a military use. The new list of items would be set forth in Supplement No. 2 to Part 744. At present, these items can be exported to China without a license.

The new list of items is quite limited, having been reduced from earlier (unpublished) drafts of the rule. It contains only a fraction of the items on the Commerce Control List that are likely to

contribute to China's military strength. And the Commerce Department has signaled its openness to further diminution of the proposed list by inviting industry proposals for removal of additional items. Commerce should not weaken this new control by eliminating items based on their "availability" in China or elsewhere abroad. The Chinese military seeks to acquire dual-use American goods and technologies so that they can be reverse-engineered and utilized to improve similar but inferior products made in China or imported from elsewhere. The proposed control seeks to inhibit such activity, and should not be undermined by the mere existence of these inferior foreign "equivalents."

To have a greater impact, the scope of the rule should be expanded, by enlarging the list of items subject to the new control, or even by eliminating the list altogether. If an exporter knows that an item subject to the Export Administration Regulations is intended for a military purpose in China, the exporter should be required to apply for a license. Such a general "catch-all" clause would be far more effective than the proposed list of controlled items.

A second weakness in the draft rule is that it does not name Chinese military buyers. The "knowledge" test is extremely weak unless an effort is made to help the exporter acquire the requisite knowledge. If a Chinese buyer is unquestionably doing military work, that should be part of what the exporter "knows" about a sale to such a buyer. As things stand now, the Commerce Department has named only a handful of Chinese military organizations on the present "Entity List." This List concentrates on entities doing nuclear and missile work, and is not directed at military firms generally. Other countries have warning lists that are much broader, and so should the United States.

For the new control to have a meaningful impact on preventing exports that assist China's military capability, exporters should be educated about Chinese military end-users. Industry has reasonably requested that a list of "targeted" end-users be made part of any guidance on complying with the new controls. And it would be a simple matter to list such organizations -- their activities are described in open sources. The publication of such a list will ease the burden on exporters of performing due diligence under the new rule. The appearance of an end-user on the list could serve as a "red flag" requiring further investigation by the exporter. Alternatively, the exporter could be required to apply for a license if the intended recipient was listed. To be effective, a public list of Chinese military end-users would need to include contact information and related entities (subsidiaries, parents, siblings, etc.) The list would also need to be refreshed regularly. If such a list is published, it should be accompanied by clarification that an exporter of a listed item to China who "knows" of an intended military use is required to apply for a license, whether or not the intended recipient is on the list.

Proposed Authorization Validated End-User (VEU)

This proposed authorization is unclear, and may be unnecessary. Certain Chinese companies would for the first time be allowed to receive controlled American products without an export license. The Department of Commerce would create the list of these privileged Chinese companies by determining that the companies were engaged only in civilian activities. A company on the list would be designated a "Validated End-User (VEU)," and would be allowed

to receive American products in specified categories license-free. The proposed authorization should not be adopted, at least not without substantial revisions and clarifications.

The VEU scheme is intended to speed up legitimate exports to civilian end-users, and to offset the compliance burden of the new military catch-all requirement for China. But industry commentators doubt the proposed VEU authorization will have this beneficial effect. To take advantage of VEU, exporters would need to comply with substantial new reporting requirements. And both exporters and end-users would need to consent to audits by the U.S. government. Industry experts suggest that few foreign companies – particularly Chinese companies – would be willing to agree in advance to such audits. Industry advocates also suggest that, rather than comply with the qualification and procedural requirements of VEU, it would be easier for exporters to simply continue applying for individual export licenses. Thus, VEU is unnecessary because it will not be widely utilized to reduce the compliance burden on the Commerce Department and exporters. Indeed, a similar scheme was tried two decades ago, but it was not used by industry and was terminated in short order.

The requirements of the proposed VEU scheme are too burdensome for industry to use it. But these requirements are not sufficient to ensure that the scheme does not undermine national security. And the Commerce Department does not have the resources to ensure that the VEU scheme is implemented efficiently while protecting national security.

Fundamentally, each export of a controlled dual-use item is scrutinized *a priori* if an export license is required (and applied for by the exporter). Under the proposed rule, exports of specified sensitive dual-use items to VEUs would no longer be checked, indefinitely. The rule requires annual reports detailing exports under the scheme, and promises periodic compliance audits. But these measures would all be too late to stop a questionable export that was not examined before it took place.

The rule mandates no procedures to deal with changed circumstances after a VEU is listed. Should a VEU designation not be re-examined in cases of reorganization or change in ownership, to check for new risks of non-civil end-use? And what if an exporter would like to expand the list of items a VEU is allowed to receive without a license? Should not the VEU be re-examined in such a case, to rule out non-civil end-uses for the new items? These are but two situations which would require additional scrutiny by the Commerce Department, but are left unaddressed in the proposed rule.

The rule should also make clear that the "knowledge" standard would continue to apply to an exporter's actions vis-à-vis an entity listed as a VEU. This should be true both for the existing nonproliferation requirements and for the proposed China military control (if it is adopted). For example, if the exporter learns that a buyer already on the VEU list intends to use the product for a military purpose, or to re-transfer the product to a military site, the exporter should be required to apply for a license. The exporter should be entitled to rely on the recipient's VEU designation only to the extent that the exporter is not aware of facts indicating non-civilian end-use. This clarification should be expressly noted in the rule. And the exporter should be required to inform Commerce if he discovers an intended non-civilian end-use in a transaction involving a VEU. Such notice should also trigger reconsideration by the Department of the end-user's VEU status.

The process of properly screening potential VEUs, and sufficiently verifying their civilian status on an ongoing basis, will require a substantial manpower investment by Commerce. Large Chinese conglomerates involved in trade with the United States pose a substantial risk of diversion, because they often have dozens if not hundreds of subsidiaries, many of which do military work. But Commerce managers admit that their current knowledge of Chinese military entities is insufficient. And there are almost no Commerce officials designated to carry out site visits in China. The Department is already understaffed, leading to persistent complaints regarding processing times for license applications and commodity classification requests. To move the VEU scheme along, Commerce will be tempted to rely too much on past license history, "recent" visits and industry suggestions in selecting VEUs, and to skimp on follow-up audits once VEUs are certified. Department officials have already promised swift VEU designations. Such an approach would undermine national security, and must be avoided. It would be better to shelve the scheme, at least until the Department has the resources to implement it efficiently and securely.

Overall, the VEU scheme as proposed is unlikely to be used by industry, and would undermine national security and overburden the Commerce Department. If the scheme is revised and implemented to minimize security risks, it is even less likely to be utilized by exporters. At present, it may be best to simply abandon this approach. Furthermore, it certainly seems premature and unwise to discuss expanding the VEU scheme to include Indian companies by spring 2007.

Revision of End-User Certificate Requirements

The rule also proposes to require a PRC End-User Certificate for all items controlled for export to the PRC that exceed a total value of \$5,000. Such certificates are issued by the Chinese government, contain information about the export, and provide some assurance that the exported item would not be misused in China. The proposed change is a potential security improvement, as such certificates are currently required only for exports controlled for national security reasons.

However, the rule also proposes to eliminate the requirement that exporters submit the certificates with their license applications. This seems counterintuitive, as the certificate should be a key supporting document for evaluating the application. Unless Commerce has an up-to-date, easily searchable database of all such issued certificates, exporters should be required to continue submitting these documents with their license applications. Once the exporter has procured the certificate, sending it to Commerce is a minimal additional burden.

Conclusion

The Project supports the intent of the Commerce Department to control sensitive American exports to the PRC. We hope that the Department will find our comments and suggestions to be

of value. We are grateful for the opportunity to present our views, and look forward to doing so again in the future.

Respectfully submitted,

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