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REAUTHORIZATION OF THE DEFENSE PRODUCTION ACT

HEARING

BEFORE THE

SUBCOMMITTEE ON ECONOMIC POLICY

OF THE

COMMITTEE ON
BANKING, HOUSING, AND URBAN AFFAIRS
UNITED STATES SENATE

ONE HUNDRED SEVENTH CONGRESS

FIRST SESSION

ON

THE PROPOSED LEGISLATION AUTHORIZING FUNDING FOR THE DEFENSE PRODUCTION ACT

JUNE 27, 2001

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C O N T E N T S

WEDNESDAY, JUNE 27, 2001

WITNESSES

REAUTHORIZATION OF THE DEFENSE PRODUCTION ACT

WEDNESDAY, JUNE 27, 2001

U.S. SENATE,
COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS,
SUBCOMMITTEE ON ECONOMIC POLICY,
Washington, DC.

The Subcommittee met at 2:30 p.m., in room SD–538 of the Dirksen Senate Office Building, Senator Charles E. Schumer (Chairman of the Subcommittee) presiding.

OPENING STATEMENT OF SENATOR CHARLES E. SCHUMER

Senator SCHUMER. Let me call our Subcommittee hearing to order, and thank all of our witnesses. I apologize for it being later than scheduled. As you know, we had a vote on the floor. I want to thank my colleagues, particularly our Chairman for being here this afternoon.

This is my first hearing as Chairman of the Economic Policy Subcommittee and I wanted to take a moment to thank Senator Bunning, in absentia. He told me a few minutes ago he could not make it, for his tenure as Chairman. We worked closely together during that time and I look forward to an excellent working relationship with him over the next year.

It will come as no surprise, that I am in the process of planning an active Subcommittee agenda and anticipate holding a number of hearings in the coming months, although probably none as scintillating as our hearing today.

[Laughter.]

I have made provisions for an overflow room if anybody would like to use it.

[Laughter.]

But I look forward, seriously, to working with the Subcommittee Members on issues of interest to them. I am very pleased to welcome our witnesses and the New Yorker on our panel, Under Secretary Juster. There always seems to be a token New Yorker at the table in our hearing room, so I am glad that you are meeting our expectation, Mr. Secretary. I also want to welcome Michael Brown, the General Counsel of FEMA. Eric Fygi, the Deputy General Counsel for the Department of Energy, Delores M. Etter, the Acting Director of Defense for the U.S. Department of Defense, and Paul Halpern. I would just ask that our witnesses be mindful of time allotments. I know that some of our Members are going to be called away and I want everyone to have an opportunity to ask questions.

The purpose of the hearing is to review the Defense Production Act in preparation of its reauthorization, which expires in October. It is a little known Act, with tremendous delegated authority.

The law was enacted at the outset of the Korean War to ensure the Department of Defense had sufficient industrial resources available to conduct the war effort. Today, the Act's most important authority continues to be ensuring that we can respond immediately to national emergencies and meet all threats to our national security, from weapons of mass destruction to cyber or biological terrorism.

DPA continues to be a law necessary to provide for the common defense and there appears to be no disagreement about that. Where there is disagreement is about whether legislative changes are necessary to ensure that the Act is properly employed.

Last February, the Full Committee under Chairman Gramm held a hearing into the use of DPA authority during the California electricity crisis. The hearing examined whether Federal orders that required natural gas suppliers to continue to supply California's Pacific Gas and Electric during volatile market conditions constituted an inappropriate use of the Act.

The Clinton Administration and the current Administration subsequently affirmed that the threats of black-outs to California's military bases constituted a threat to national security and the orders were therefore appropriate. This instance and the resultant controversy over the orders has led to the acute concern among some Committee Members that the Act could be used to intervene in civilian markets when there is only an indirect threat to national defense.

And if you believe in Adam Smith, it is hard not to be sympathetic to those Members' concerns since requiring the sale of goods and services at government-mandated prices can disrupt and distort markets. I am happy to have the opportunity at this hearing to explore these issues and any others that Members might have.

The Administration has asked us to reauthorize the Act for 3 years without legislative changes. I think there are some Committee Members who will look for some accommodation and I would ask that the Administration hear the concerns of these Members and work with them, myself, and the Chairman of the Full Committee so that we can accomplish the reauthorization of this Act before its expiration. I am sure we all agree, letting this Act expire is simply not an option.

Thank you and with the permission of our two Republican Members, I would recognize Chairman Sarbanes first.

Senator SARBANES. Thank you, Mr. Chairman. I would defer to Senator Bennett.

Senator SCHUMER. Okay. Then we will go to Senator Bennett, if he would like to make an opening statement.

STATEMENT OF SENATOR ROBERT F. BENNETT

Senator BENNETT. Thank you, Mr. Chairman. I appreciate your and Chairman Sarbanes' courtesy. I am one of those who thinks that simply extending the Act for 3 years without change would be a mistake. The world has changed very dramatically since this Act was drawn in 1950. There have been some changes to it since then.

But the world has been changed dramatically in the last 5 years, not just the last 50 years. And the focus goes from dealing with weapons of mass destruction to dealing with weapons of mass disruption.

We had a hearing in the Joint Economic Committee where the CIA spoke with us about how within the next 5 years nation states would provide the biggest cyber-threat to the disruption of U.S. networks and critical infrastructures. And we recognize that virtually every government agency, including the Department of Defense, is completely dependent upon the civilian infrastructure to carry out its work.

There was a time when an officer in the Pentagon could pick up the phone, get the commander in the field, and it would be on a secure DoD telephone system. Today, when he picks up the phone at the Pentagon, he's on Verizon's telephone network.

Future attacks against the United States will not only be against the government or defense production facilities. These attacks will be against any part of our infrastructure that an attacker feels could bring down the U.S. economy and move the focus from weapons of mass destruction to weapons of mass disruption.

The bottom line is that the U.S. infrastructure and computer systems are going to remain the targets of attack well into the future. We discused these possiblilties in terms of assessment when we did the Y2K activity. I worked very closely with John Coscanan, who was the president's Y2K czar. John Coscanan worked on a review of our vulnerabilities. Coincidentally, we got to the end of the Y2K situation and we had solved that particular problem before the review that John Coscanan worked on could be brought to light with the kind of publicity that I think it deserved.

There is sufficient confusion about the role that the Defense Production Act should play in reconstructing our critical infrastructure if an attack took place, that I would prefer that we authorize the Act unchanged for one more year and use that year to examine all of the issues that the Clinton administration began an examination of and that I was a part of, that simply did not happen when Y2K came without a problem and everybody heaved a sigh of relief and said, well, we do not have to worry about that any more. We do have to worry about it.

Y2K was an example of what could happen if the computers failed by accident. We need to pay attention to what could happen if the computers fail on purpose. And the Banking Committee, with its jurisdiction over the Defense Production Act, is near ground zero at the question of protecting and refinancing a restructuring of the American economy if these kinds of attacks occur.

For that reason, Mr. Chairman, I will be one to say that it would be unthinkable to let this law lapse without being reauthorized. But I would hope that we would not just reauthorize it for 3 years and go on with the same inattention that we have shown. I would hope that we would authorize it for 1 year and use that 1 year for a very active reexamination of its proper role and what we in the Banking Committee can do to prepare ourselves for the future.

Thank you, Mr. Chairman.

Senator SCHUMER. Thank you, Senator Bennett. And now our full Committee Chairman, Senator Sarbanes.

STATEMENT OF SENATOR PAUL S. SARBANES

Senator SARBANES. Thank you very much, Chairman Schumer.

First of all, I want to commend you for holding today's hearing and carrying forward a very important responsibility of the Banking Committee. We are delighted to see you in the Chair and we look forward to many constructive contributions. And I also want to state that I am certain that the cooperative relationship that has existed between you and Senator Bunning under previous arrangements will continue under the new arrangements.

The Defense Production Act is one of five statutes under the jurisdiction of the Banking Committee which will expire later this year, and on which we have focused right off the bat. We have been holding hearings on those measures. I hope that we will be able to proceed with mark-ups for reauthorizations next month.

The other statutes are the charter of the Export–Import Bank, the Iran–Libya Sanctions Act, on which there will be a hearing tomorrow morning, the Multi-Family Assisted Housing Reform and Affordability Act, the so-called mark-to-market, which needs an extension of its authorities, and the Export Administration Act, which has been reported out of the Committee and Senator Enzi was very much involved in that, and is now awaiting action on the floor of the Senate. I would hope that we can move all of these matters next month in terms of moving along toward enactment.

The Defense Production Act provides the President a number of authorities to ensure the availability of industrial resources to meet national security needs and to deal with domestic civil emergencies. The Administration is requesting a reauthorization for 3 years of the DPA. Incidentally, the Administration supports reauthorization of all of these other measures which I previously outlined as part of our Committee's work agenda.

Actually, Mr. Brown from FEMA says in his prepared statement, and I quote him, with respect to the DPA: "The expiration of these provisions could have a severe impact on the Nation's emergency resource preparedness to meet threats to our national security." And then further on, he says: "We may also need to use DPA authorities to respond to other catastrophic civil emergencies. The Administration views the possibility of such expiration as disruptive to ongoing programs under the Act."

As Chairman Schumer outlined in the beginning, the DPA is a statute that does not attract a great deal of public attention until some other problem or crisis develops that requires the use of its authorities and Senator Bennett underlined the importance of that. Senator Bennett has an ability to focus on important matters that tend to get overlooked. He was early on the Y2K problem and, working with Senator Dodd, provided tremendous leadership here in the Congress in trying to address that problem.

And, as he just indicated in his statement, he's also focused on these DPA authorities and their importance. This is really part of the Committee doing its basic work, and I think we need to address this issue with a great deal of seriousness and concern. Chairman Schumer, thank you very much for scheduling this hearing.

Senator SCHUMER. Thank you, Mr. Chairman.

Mr. Enzi.

STATEMENT OF SENATOR MICHAEL B. ENZI

Senator ENZI. Thank you, Mr. Chairman. The reauthorization of the Defense Production Act will require careful thought and a re-evaluation of the role that this Act plays in affecting different aspects of our Nation's productivity, security, and ability to respond to moments of national crisis. In my opinion, there is a question that the Act can benefit our armed forces in ensuring that they have the latest equipment available in a timely manner and that they are prepared and able to defend our Nation's interests.

But the Defense Production Act has another side to it that, when used improperly, can have a severe rippling effect on many different areas of the country. In my opinion, the main use of this has been a misuse.

When the Act was used at the end of last year to require natural gas sales to California energy producers, at best, a very tenuous connection was made to the Act's role as a national security insurance statute. While it is true that electricity producers in California do supply some energy to California's military installations, the extent and imminence of any threat to those installations was not clearly established before the Act was invoked.

Testimony that was heard before the Full Committee at its February 8 hearing indicated that national defense was actually a secondary justification for the use of the Act, when the true primary purpose was requiring natural gas suppliers to continue delivering gas to the California industries, was to provide fuel at a much lower rate than would have been otherwise available. otherwise. And that wasn't my biggest concern. It is kind of a domino effect when some of the small Wyoming producers had to send gas down there without any definite assurance that they would be paid for their gas.

The company taking it was perhaps bankrupt and the Federal Government was accepting no responsibility for it. You cannot have small businesses left hanging out by an act of the Federal Government without them taking some responsibility.

The Defense Production Act therefore must be reviewed and protections need to be put in place to protect consumers and industries from Defense Production Act abuse. When the Defense Production Act was invoked, it placed a superior priority on California Energy Development. Had a conflict arisen between providing energy for California and any of the company's other contracts, the Defense Production Act would have required contractors to fill California's demands first. Only after California was adequately provided for could any energy left over be used to fill the needs of other States, including my State.

This should not occur. The Act also suspends civil remedies that would have been available to energy suppliers in the event of a default. The Federal Government required companies to sell natural gas without any guarantee they would ever receive payment.

Short-term band-aids and Federal intervention, like the intervention into the California energy crisis, have the potential of making matters worse than they currently are. It is clearly a case of the cure being much worse than the disease.

I am deeply concerned that the if the Defense Production Act is not amended to protect industries from abuse, then the Act itself

will become the real threat to our energy supplies, our jobs, and our industries.

Given the potential for abuse and certain questionable uses for that authority, I must seriously consider the wisdom of the proposal of a 3 year extension without a significant reevaluation of the Act's application. I have allowed a 1 year extension twice already and I have been bitten once.

Mr. Chairman, I thank you for the opportunity for this hearing and look forward to the information that will come out of it and the discussion and debate that will ensue. Thank you.

Senator SCHUMER. Thank you. And thank you and Senator Bennett for your real interest in this, as Senator Sarbanes said.

Senator Corzine.

COMMENTS OF SENATOR JON S. CORZINE

Senator CORZINE. Thank you, Mr. Chairman. It is a pleasure to be here in your first Subcommittee hearing. I believe this is an important discussion we are having about reauthorization.

Some of us can look at the same facts that I think have been spoken about and wonder about where the trade-offs actually lie with regard to what is our security interest. And I hope that these hearings will help clarify that as we go through this reauthorization process. I think that this is a fair subject to debate. I am not certain that the outcomes will always be consistent from the different beholders of the facts.

Senator SCHUMER. Well, thank you, Senator Corzine. And I want to thank everybody for being here at least at the initial hearing where I am chairing this Committee, which is a great honor.

And now we will call on each of our witnesses and ask them to try and—there is a little clock here that will change color from green to yellow when you have a minute left, to red when your time is up.

Mr. Juster.

STATEMENT OF KENNETH I. JUSTER
UNDER SECRETARY FOR EXPORT ADMINISTRATION
U.S. DEPARTMENT OF COMMERCE

Mr. JUSTER. Thank you, Mr. Chairman, and Members of the Subcommittee. I appreciate the opportunity to testify on the reauthorization of the Defense Production Act. I have submitted a written statement which I hope could be included in the record and I will just briefly summarize my comments.

Senator SCHUMER. Without objection, your statement and the statements of the other three witnesses as well will be printed in the record.

Mr. JUSTER. Thank you. I would like to focus my comments on those authorities of the Defense Production Act that are relevant to the Department of Commerce. The Department plays several roles in implementing those DPA authorities that relate to the defense industrial base. First, under Title I of the DPA, the Department administers the defense priorities and allocations system. Second, under Title III, the Department reports on defense trade offsets. Third, under Title VII, the Department analyzes the health of U.S. defense industrial base sectors. And fourth, also under Title

VII, the Department plays a significant role in analyzing the impact of foreign investments on the national security of the United States. I will touch briefly on each of these four roles.

The defense priorities and allocation system, which is known as DPAS, has two purposes. First, it ensures the timely availability of products, materials and services that are needed to meet current national defense and emergency preparedness requirements, with minimal interference to the conduct of normal business activity. Second, it provides an operating structure to support a timely and comprehensive response by U.S. industry in the event of a national security emergency.

Under Executive Order 12919, the Department of Commerce administers this DPAS system in accordance with the priorities and allocations provisions of the Defense Production Act. Those provisions provide authority for requiring U.S. companies to accept and perform contracts for orders necessary to national defense and civil emergency needs. They also provide authority for managing the distribution of scarce and critical materials in an emergency.

Under this system, the Department delegates to several Federal agencies, including the Departments of Defense and Energy, the authority to use the system to obtain critical products, materials and services to meet approved program requirements. In the vast majority of these cases, the procuring Federal agency and the contractor quickly come to mutually acceptable terms for priority production and delivery.

Only if the company and the delegated agency cannot reach such agreement does the Department of Commerce, as the primary liaison with U.S. industry, come into the picture and play a critical role in resolving the issue.

Turning to defense offsets, the Commerce Department provides Congress with an annual report, which we just published recently, on the impact of offsets. Defense trade offsets are industrial compensation practices required as a condition of purchase in either government-to-government or commercial sales of defense articles or services. For example, a foreign government may agree to purchase jet fighters from an American company, but could insist that the engines for the jets be produced in the foreign country using local suppliers.

We believe that offsets are economically inefficient because the foreign customer is basing the purchase decision on something other than the quality of the product or service being provided. Any unilateral action on offsets could have a negative impact on the competitiveness of our prime contractors in world markets, we believe that we should attempt to address the issue of offsets in bilateral and multilateral settings.

The third area where the Department of Commerce utilizes authorities under the Defense Protection Act relates to reports that we prepare on individual sectors of the defense industry. These studies are either self-initiated or requested by the armed services, the Congress or industry itself. The studies provide a comprehensive review of specific sectors within the U.S. defense industrial base and they gauge the current capabilities of these sectors to provide defense items to the U.S. military services.

The final area where we rely on DPA authorities relates to the Committee on Foreign Investment in the United States, the CFIUS. The Department of Commerce is a member of this Committee, which is chaired by the Department of the Treasury.

In 1988, the President delegated to this Committee certain of his responsibilities under section 721 of the DPA, which is known as the Exon–Florio provision. The intent of that provision is to provide a mechanism for review and, if the President finds necessary, for suspension and prohibition of a foreign direct investment that threatens national security. But it is not the intention of this provision to discourage foreign investment in the United States.

In summary, the DPA provides essential authorities for a variety of important programs at the Department of Commerce. We therefore support extending the Defense Production Act for a 3 year period for purposes of continuity and stability in terms of these essential authorities.

But I should hasten to add in response to the comments that have been made already that we are as an Administration currently reviewing the entire issue of critical infrastructure assurance and how the government will organize itself on that matter. We are committed in the context of that review and the national plan that we are intending to issue by the end of this year, to analyzing the authorities that we would require to undertake critical infrastructure assurance and how those relate to the Defense Production Act. So I want to assure Senator Bennett that that is something very much on our minds as well. Thank you very much.

Senator SCHUMER. Thank you, Mr. Juster.

Mr. Brown.

STATEMENT OF MICHAEL D. BROWN
GENERAL COUNSEL
FEDERAL EMERGENCY MANAGEMENT AGENCY

Mr. BROWN. Thank you, Mr. Chairman, Members of the Committee. I am certainly pleased to be here today to testify on the DPA on behalf of Director Allbaugh. Rather than go through my written testimony, I would like to offer just a few comments, if the Chairman doesn't mind.

The Administration does request a 3 year reauthorization of the Act. We believe that this continuity is important to carry out the duties and the obligations of FEMA as the lead coordinating agency on behalf of both the National Security Council and the White House.

FEMA is prepared to fulfill our obligations under Executive Order 12919, which indeed involve things such as coordination. We are a coordinating agency and, frankly, we think we do coordination pretty darn well. The expiration of the Act will hinder us in our full capacity to do that coordinating role and to carry on that type of activity.

The DPA itself gives us the additional tools and, in fact, I would say that it gives us the tools of last resort that we need in the event of what I would call a truly catastrophic event that goes beyond the Stafford Act, that goes beyond the capabilities of FEMA to actually react properly, to coordinate and to do our job. There-

fore, we believe that the expiration of the act does have serious or dire consequences for FEMA.

You may recall that President Bush has tasked Director Allbaugh with the creation of the Office of National Preparedness. We have done so. We believe that the reauthorization of the DPA is vital to the continued function of that particular office.

We may actually be looking to the DPA for authorities to respond to consequences of mass destruction or, as we have heard today, weapons of mass interruption. I think that is a very poignant term that we ought to focus on.

We believe that the authorities contained in the DPA are essential as tools of last resort in our management of those types of incidents. In addition to that, we have within FEMA undergone a major reorganization and realignment. Within that realignment, we have created a new office that is tasked with the responsibility of coming up with plans and procedures to respond to catastrophic disasters. This office is also tasked with the function, to study the DPA and how those authorities might be used in instances of truly catastrophic incidents.

In summary, the linkage between the DPA and the Stafford Act ensures the availability of needed resources when the nation is facing a truly catastrophic disaster, whether that disaster is natural or man-made.

Therefore, we urge the Congress to reauthorize the DPA in its entirety, as written, for at least 3 years. Thank you, Mr. Chairman. I would be happy to respond to any questions.

Senator SCHUMER. Thank you, Mr. Brown.

Mr. Fygi.

STATEMENT OF ERIC J. FYGI, DEPUTY GENERAL COUNSEL

U.S. DEPARTMENT OF ENERGY

Mr. FYGI. Well, thank you, Mr. Chairman. Since much of your own opening remarks harkened back to the California experience that was the subject of the February 9 hearing, perhaps I can summarize for the benefit of those who were not in attendance at that hearing the factual circumstances that prompted the resort to the Defense Production Act.

Those factual circumstances comprised a threat, an actual threat of physical interruptions of deliveries of natural gas for the entirety of the north and central areas of California, which happened to be serviced by a major combined gas and electric utility.

The reasons for the resort to the authorities in the Emergency Natural Gas Act, as complemented by the authorities under the Defense Production Act, were not, as was erroneously stated by Senator Enzi, to control prices. The reasons were to assure continuity of supply in the extraordinary and unprecedented circumstance that this country had never experienced, one where some 3.9 million customers in a significant portion of the country that includes significant industrial activity directly relevant to defense security and defense activities was threatened by dint of an approaching insolvency and liquidity crisis of a regulated utility.

The immediate problem was not that the utility did not have the capacity to secure revenues equal to its expenditures for natural

gas acquisition costs. California's tariff for the gas utilities was more rational than that for electricity provision at the retail level.

What prompted the emergency was that the overall financial posture of that utility, including the downgrading of its bond instruments and credit ratings by the major rating agencies, prompted gas suppliers to begin terminating delivery of supplies to the entirety of that region through Pacific Gas & Electric Company.

Had that occurred, that event in turn under California law would have prompted the need by that utility to cease delivery of others' natural gas for electric generating purposes in order to make continued deliveries to so-called core retail customers. So that there was a substantial and immediate risk of a cascading situation that would have resulted in a significant outage of the already-stressed electricity posture in California.

Now the problems that stemmed, or that I have heard identified, stemming from this resort to the two authorities—the emergency natural gas provisions of the Natural Gas Policy Act, coupled with the Defense Production Act—essentially are twofold.

First, the criticism suggests an impropriety in resorting to these authorities when there was a risk of nonpayment of the natural gas supplies. And granted, there was a risk of nonpayment.

I am pleased to report that 100 percent of the gas suppliers whose volumes were made available pursuant to the emergency orders made at the end of the Clinton Administration and continued by President Bush for the first 2 weeks of his Administration, have in fact been paid in full. The threats of adverse economic consequences to the gas suppliers proved unfounded.

The reason that they were proven unfounded was that this small period of reprieve that stopped a run on the bank in northern California—that is the closest analogy that I can think of—afforded the State and other institutions sufficient time to come to grips with the circumstances, including changing somewhat the tariff posture of the utility in question that granted additional assurance to gas suppliers that they would be paid from the revenues received by the utility from customers buying natural gas, which was the nub of the problem, such that we have not seen a recurrence.

Finally, as to the appropriateness as a matter of law of resort to the Defense Production Act here, it is well to remember that, in addition to defense production in the classical sense of hard goods, the Defense Production Act contains a separate subsection dealing with continuity in provision of energy was specifically amended in 1980 to specify a statutory linkage between continuity of energy supplies and maintenance of the national security interests of the United States. Thank you very much, Mr. Chairman, and I will be pleased to respond to any questions you may have.

Senator SCHUMER. Thank you, Mr. Fygi.

Ms. Etter.

STATEMENT OF DELORES M. ETTER
ACTING DIRECTOR
DEFENSE RESEARCH AND ENGINEERING
U.S. DEPARTMENT OF DEFENSE
ACCOMPANIED BY PAUL HALPERN

Ms. ETTER. Thank you. I appreciate the opportunity to share with you the Department of Defense's views regarding the Defense Production Act and the role it plays in helping to obtain the goods and services needed to promote the national defense. I also want to express the Department of Defense's support for reauthorization of the Act through September 30, 2004. A strong domestic industrial and technology base is one of the cornerstones of our national security. The Act provides the department essential tools required to maintain a strong base that will be responsive to the needs of our armed forces. Three authorities—Title I, III and VII—continue to be of vital importance to the Department.

Title I provides the President the authority to require preferential performance on contracts and orders to meet approved national defense and emergency preparedness program requirements. During peacetime, Title I authorities, as implemented through the DPAS system, and applied via contract clauses, are important in setting priorities among defense programs that are competing for scarce resources and backlogged parts and subassemblies.

Delayed deliveries to producers of weapons systems increase costs and affect our readiness. DPAS gives DoD an opportunity to prioritize deliveries and minimize costs and schedule delays for the department's orders and for allied nation defense procurements in the United States.

However, in the event of conflict or contingency, DPAS becomes indispensable. During operations Desert Shield and Desert Storm, the Department of Commerce, at the request of DoD, formally took acts in 135 cases to ensure that the industry provided priority production and shipment of essential items.

More recently, since 1995, DoD and the Department of Commerce have worked together to resolve more than a hundred cases of industrial conflicts among competing U.S. defense orders and to permit NATO and allied nations to obtain priority contract performance from U.S. suppliers.

Sixty-eight percent of the cases supported wartime needs in Bosnia and Kosovo for items such as satellite communication radios. Thirty-two percent of the cases supported peacetime requirements.

Finally, I would also note as we use Title I authorities, they help us engage in multilateral discussions within NATO and bilateral discussions with key allies to establish reciprocal priority agreements. Now I would like to turn to Title III.

The primary objective of Title III is to work with U.S. industry to strengthen our Nation's defense by creating, expanding and maintaining affordable and economically viable production facilities. The Title III program meets this objective through the use of financial incentives that stimulate private investment and key industrial capabilities.

The DPA also ensures congressional oversight. By law, Title III projects cannot be initiated until a Presidential determination has been made and Congress has been notified. Title III reduces the

cost of our weapons systems and promotes technology transition by improving the capabilities of our defense industrial base.

Without Title III, the insertion of these technologies in serveral of these cases would be delayed for years. Title III reduces this time by first eliminating market uncertainties and reducing risks that discourage the creation of new capacity and the use of advanced technologies.

Second, Title III results in reduced costs and increased demand. And third, it creates information about materials needed by the design community to incorporate these new materials into defense systems.

There are currently eight active Title III projects and we are initiating a new thrust into radiation-hardened electronics. This new initiative will establish a domestic production capacity for radiation-hardened electronics materials and components to support both strategic missile and space systems.

I would also like to mention one program in Title VII that is of particular importance to us, section 721. Section 721 allows the President to suspend or prohibit foreign acquisition of a U.S. firm when that transaction would present a credible threat to the national security of the United States and remedies to eliminate that threat are not available under other statutes. Administration of this section has been delegated to the Committee on Foreign Investment in the United States—CFIUS—which is chaired by the Department of the Treasury.

The DoD considers the CFIUS review to be an essential and effective process for analyzing the national security implications of foreign acquisitions of U.S. companies in resolving issues related to these transactions.

The DoD has its own industrial security regulations which are used to review foreign acquisitions where classified contracts are involved. However, CFIUS is important because it provides additional coverage of firms developing dual-use technologies that are export-controlled, but unclassified.

In addition, the CFIUS review process is an interagency process which allows all Federal departments to coordinate their analyses of the national security implications, balance risks of disclosure against the benefits of foreign investment, and impose necessary risk mitigation measures to eliminate threats to national security.

In conclusion, the DoD needs the Defense Production Act. It contains authorities that exist where no others do, and I hope I have conveyed to you the significant role that those authorities play in ensuring our Nation's defense. Thank you.

Senator SCHUMER. Thank you, Dr. Etter. And now we are ready for questions. I first want to thank all the witnesses for their testimony. Let me ask you a question relevant to my State. I think one of the major concerns that some of the members of this Committee, and I know Senator Gramm has raised as well, is the use of DPA in the California situation as it sets a precedent. So as you are aware, New York is facing the possibility of energy shortages. Some estimate if we have a very hot summer, we could run into California-like problems in August. We do not know the predictability. We cannot predict the difficulty we will have, but we are taking steps in the State to address the problem.

My question is, would the Administration consider issuing a Federal order similar to that issued in California if New York were facing the threat of a rolling blackout? Dr. Fygi mentioned that the energy nexus is sufficient to use DPA. We also have some areas vital to our national defense—Fort Drum, the Brookhaven National Labs. What is the opinion of the witnesses on that issue?

Dr. Fygi. Mr. Fygi.

Mr. FYGI. That is all right. Sometimes people call me doctor. But I think sometimes it is more like a saloon doctor than an MD.

[Laughter.]

I cannot foresee or predict whether we will be confronted with a situation like California's. As I indicated in my opening summary, the California circumstance was quite unlike anything the Nation has ever experienced—the actual physical interdiction of gas volumes affecting the entire service area of a major combined gas and electric utility.

There is nothing that we have seen that I am aware of in the other areas of the country that might themselves be experiencing some tension in continuity of electric service, for example, that approaches the immediate emergency circumstance that confronted us in California during the winter. The only really accurate answer I can venture is that I believe it extremely unlikely that we will be confronted with a replication of the circumstances in California.

Also, the Administration might well decide to employ different techniques were any Federal intervention called for. I would not want to suggest that direct Federal regulatory intervention would be the first choice in determining courses of action.

Senator SCHUMER. Right. But if they determined—that is a good try, Mr. Fygi.

[Laughter.]

I understand the Administration probably would not want to do it, although they did in California. My question was: Would the nexus of the electric grid, in your judgment, and our military facilities, or military-related facilities, provide enough justification to use DPA, if the administration were to determine it wanted to, and if New York's crisis merited it?

Mr. FYGI. In other words, if I might presume to restate the question, are you asking whether we are creative enough lawyers to concoct a circumstance in which the DPA could be employed for New York in such a setting?

Senator SCHUMER. Yes.

Mr. FYGI. Well, at least my presumptuousness was accurate, if nothing else. I do not know the answer to that because—

Senator SCHUMER. It had a real purpose. I would not want, if, God forbid, we were in the state that California is in in August and say, here's DPA. And then have one of you folks come to me and say, well, DPA doesn't really reach here.

Mr. FYGI. Well, the DPA regime does, in fact, by its text, reach circumstances where the President determines its invocation is necessary to assure continuity of energy supplies and actions to enhance continuity and amount of energy supplies. So that, in one sense, there is a prong of the Defense Production Act that is not so dependent on a direct defense production nexus, as perhaps your question implies.

I certainly would not want to rule it out. But I hasten to add that we are not searching for new ways to employ direct Federal interventionist techniques in the marketplace.

Senator SCHUMER. Okay. Anyone else want to comment on that question?

[No response.]

I did not think they would be lining up.

[Laughter.]

The second question I have is, Senator Bennett and I, and he mentioned it, have shared a concern about cyber-terrorism. We have worked together on this issue. Do any of you believe that additional authority is necessary to address this new type of threat to national security?

Mr. JUSTER. As I mentioned in my opening statement, I think that is an issue that we need to look at closely as we review critical infrastructure assurance matters generally and as part of the national plan that we are hoping to issue by the end of this year.

Certainly, if a cyber-event rose to a catastrophic level, I think one could say that the DPA would apply because of a national security. But whether in other circumstances the DPA would apply or not, or whether there are other authorities available, is one of the issues that we want to study and review as part of our overall analysis of critical infrastructure assurance.

Senator SCHUMER. Would you be willing to wait 3 years?

Mr. JUSTER. No, no. As I indicated, we are committed to doing that review, hopefully, by the end of this year and as part of our national plan that we are going to be issuing. At the same time, we would like to see the Defense Production Act reauthorized for a three-year period because we think the authorities in the DPA for other purposes, as well as potentially for the purpose of critical infrastructure assurance in a catastrophic circumstance, are important and essential. We need those authorities for purposes of continuity and stability.

Senator SCHUMER. I see that my time is expired. So that you are saying is you may come back with an additional amendment after we were to renew the Act just to change it, which we could obviously do if we needed to.

Mr. JUSTER. Again, in the context of looking at the critical infrastructure assurance issue overall, that might possibly be the case.

Senator SCHUMER. Thank you.

Senator Bennett.

Senator BENNETT. Thank you, Mr. Chairman.

Mr. Juster, I am delighted to know that you are focusing on the national plan and interested in this. But is there anyone currently tasked, either in your department or in any other that you know of, or any other of the witnesses know of, with a formal review of DPA for either modernization or review with respect to the critical infrastructure protection problem?

Mr. JUSTER. I am not aware that anyone at this moment is tasked to do that. Part of the issue that needs to be resolved first is the government's own organization for dealing with critical infrastructure assurance. Once we have that decided by the President, I believe that the tasking to which you referred will probably follow shortly thereafter.

Senator BENNETT. Well, I agree that that needs to be the first step. But based on my experience in the Y2K circumstance, I can see how this can fall between the cracks pretty easily.

Mr. Brown, I do not mean to pick on your agency, but we put together in cooperation with the Clinton Administration the rapid response room. I have forgotten what we called it now. And when it was over and Y2K passed without disaster, the next question was—what happens to this facility? It cost about $50 million.

The Administration said, oh, well, we are going to give all that to FEMA. And I said, FEMA is not the place for that. This is a unique facility, a unique capability that has been created and should be preserved as it exists, for use in any kind of serious interruption of our critical infrastructure.

And because no one was formally tasked with it, a number of people thought it was a good idea, I got midnight phone calls from people in the Administration saying, would you please call OMB and tell them this is what ought to be done? I said, well, I will be happy to. But the OMB in the Clinton Administration did not listen to the junior Senator from Republican Utah very often, and they did not in this case. And I have no idea what has happened to the equipment. The facility has been dismantled. The equipment has been handed out.

I assume that you got most of it. And I assume you are using it appropriately. But it wasn't just the physical hardware that was the asset. It was the bringing together of the ability to monitor and respond quickly across organizational lines that was created there that has now been lost.

That is why I am focusing on this, Mr. Juster, that I hope it is not just, oh, we will make it part of the national plan and, yes, we will look at it, because I have experience of seeing that the bureaucracy has a way of letting this kind of a thing sift through its fingers and go back to the inertia of doing business the way we have always done business and stovepiping the issue the way we always have stovepiped it. And if ever there is an issue that does not call for stovepiping, it is this one. And the Defense Production Act is the ideal place, I think, to cut across organizational lines, think horizontally, and say, let's do something about this.

So that—

Mr. BROWN. I fully appreciate your point, Senator.

Senator BENNETT. Okay. Now I am interested in this conversation about California and New York. We live between California and New York.

Senator SCHUMER. So does everybody else.

[Laughter.]

Senator BENNETT. So does everybody else, yes.

[Laughter.]

This is not a hypothetical, Mr. Fygi. In May, hackers broke into the power grid in California. Fortunately, they were not able to shut it down. The word hacker in the lexicon I use with respect to critical infrastructure is almost synonymous with hobbyist. They are doing it just to prove that they can. They do not have malevolent ideas other than the fact that they'd like to shut it down to satisfy their ego. Had the hackers had a little more resources behind them, and I will be very specific—had they had the resources

of a hostile nation-state behind them—they might have succeeded in creating a sustained power outage in California. Now, to keep it interesting, let's say they did it in New York, so that we can keep the Chairman's attention.

[Laughter.]

Would you believe that the Department of Energy has the authority under the Defense Production Act and would use the authority under the Defense Production Act to try to facilitate recovery and reconstitution of power delivery in New York under such circumstances? Or California? Or Utah?

Mr. FYGI. The last part of your question is to try to rehabilitate, to take certain actions. The kind of action that we focused our attention to in the actual California experience was to issue an order to require suppliers to honor orders as well as existing contracts to supply PG&E with natural gas.

So it was that segment of both sections 101(a) and 101(c) of the Defense Production Act that were invoked. And it was, as a transactional matter, rather straightforward and specific since we knew exactly, by the time we finished our research, what elements of the orders would be founded on the emergency provisions of the Natural Gas Policy Act, which is most of them.

Senator BENNETT. I realize that the hypothetical I posed is a good bit more complicated than that.

Mr. FYGI. Because it is unclear as to what under your hypothetical you would envision the Energy Department seeking to do. What kind of order would you envision for, example, the President directing be issued?

Senator BENNETT. Let's say the hackers break into the power grid. The power grid is not seamless across the country, however much we might think it is. The very term, power grid, implies that everything is connected to everything in a seamless way, and it is not. It is fairly regional.

Let's say an aggressive computer hacker with the appropriate resources broke into the power grid for the northeast, and particularly for New York, and succeeded in shutting down all power in New York, including the New York Stock Exchange, the Federal Reserve Bank of New York City, and other vital financial institutions necessary to keep this country functioning economically.

There is power available elsewhere in the country, in my theoretical, but it requires some physical changes in terms of some switches as to where the power would be distributed, and it requires the kind of order that you talked about here of suppliers who say, we are going to wheel power into that area and we are going to get crews out to repair whatever damage is done. We are going to, I do not know, enlist a group of bright young hackers from NYU to try to reverse this or go after the folks at the National Security Agency—we are getting into DoD now—get into DIA, CIA, other people who monitor this kind of thing that is going on. Would there be a coordinating role and who in the government would play it to see to it that under the Defense Production Act power is restored as quickly as possible?

Mr. FYGI. Well, let me try to break down the pieces of your question starting with the last piece. Under the Defense Production Act, it is ultimately the President who decides coordination procedures.

The presidents have chosen to do so by promulgation of a series, or at least currently a pair, of effective executive orders that specify in some particularity the functioning of the priority performance of contract elements of the Defense Production Act and identify FEMA as a coordinating policy agency. But the President has latitude to deal with a particular new circumstance to erect his own new structure for dealing just with that circumstance.

Now, getting to the other elements of your question. It seems that, were there a need for accelerated acquisition of certain kinds of physical equipment that were in short supply and back-ordered, if you will, from suppliers, that is the kind of circumstance that would seem to fall relatively handily into the section 101(c), category of the Defense Production Act.

On the other extreme, however, your suggestion about work crews and the like and the bright young antihackers, as I recall it, the priority performance of contract authority in the Defense Production Act has an exclusion for personal services contracts. It does not seem engineered to deal with that kind of situation. And therefore, there might well be under your hypothetical room for application, perhaps even a robust application, of the Defense Production Act, if all of the other facts fell into place that would comport with its provisions.

But I think, again, this is a hypothetical, I have not had a great deal of opportunity to reflect on the subject matter of your questions, and therefore I would have to defer obviously to the ultimate work product of the more studied analyses that are ongoing and currently planned, to which some of the other witnesses already have adverted.

Senator BENNETT. Thank you, Mr. Chairman. I do not want to prolong this. I just raise this as an example of why I think there should be a careful review of the Defense Production Act, to see if in the new world we confront there ought to be some changes, including, the one that you focused on that maybe the acquisition of services might come in under the Act. I just do not know.

I am not prepared to argue in favor of any particular changes at all at this moment. I just raise this as an example of the kind of thing that we ought to be looking at. Thank you, Mr. Chairman.

Senator SCHUMER. Thank you, Senator. And I want to thank all of our witnesses for their testimony and leave the record, with unanimous consent, open for 5 days in case others on the committee, or Senator Bennett or myself, wish to submit additional questions in writing. And I think we will be calling upon you as we move forward with the reauthorization of the Act.

Thank you. The hearing is adjourned.

[Whereupon, at 3:30 p.m., the hearing was adjourned.]

[Prepared statements for the record follow:]

PREPARED STATEMENT OF SENATOR JIM BUNNING

Mr. Chairman, I would like to thank you for holding this important hearing and I would like to congratulate you on presiding over your first subcommittee hearing as Chairman. Our hearing today is on the Defense Production Act or DPA.

I do not think there is any debate on whether or not the DPA is a valuable piece of legislation, that is much needed to preserve our national defense. However, I and some of my colleagues do have some concerns over how the DPA has been used, specifically and most recently in California. I think there is still debate over whether what was done by invoking the DPA and the Natural Gas Policy Act in January was a violation of the letter of the law. But it certainly was a violation of Congressional intent.

I believe we must change the language of the DPA so it is not used as a de facto price control again. I am very concerned that a clean, 3-year reauthorization will be too tempting a tool to use again, if, God forbid, we face more blackouts. The DPA should be used only for national emergencies, not rolling blackouts.

Mr. Chairman, I do think that Chairman Sarbanes and yourself should be commended for trying to work in a bi-partisan fashion to move one of the Bush Administration's bills. I cannot support a 3-year extension without improvements to the law. Let me say again: the DPA should be used to protect our national security, not to control prices. I look forward to working with you, other Members of the Committee and the Administration to hopefully find a solution that is agreeable to all. Thank you Mr. Chairman.

PREPARED STATEMENT OF KENNETH I. JUSTER

UNDER SECRETARY FOR EXPORT ADMINISTRATION, U.S. DEPARTMENT OF COMMERCE

JUNE 27, 2001

Mr. Chairman, Senator Bunning, and Members of the Subcommittee, I appreciate the opportunity to testify on the reauthorization of the Defense Production Act. The Act expires on September 30 of this year. I urge the Congress to reauthorize the Act for at least a 3-year period. The Defense Production Act (DPA) of 1950, as amended (50 U.S. C. App. 2061, et seq.), has enabled the President for more than 50 years to ensure our Nation's defense, civil emergency preparedness, and military readiness. The DPA provides the statutory framework to enable the administration to meet future threats to our national security in light of a streamlined armed forces, a consolidated defense industrial base, and a globalized economy.

I will focus my comments on the DPA authorities that are relevant to the Department of Commerce. The Department of Commerce plays several roles in implementing those DPA authorities that relate to the defense industrial base. First, under Title I of the DPA, the Department administers the Defense Priorities and Allocations System. Second, under Title III, the Department reports on defense trade offsets. Third, under Title VII, the Department analyzes the health of U.S. defense industrial base sectors. And fourth, also under Title VII, the Department plays a significant role in analyzing the impact of foreign investments on the national security of the United States. I will briefly discuss each of these roles.

I. Defense Priorities and Allocations System

The Defense Priorities and Allocation System (known as "DPAS") has 2 purposes. First, it ensures the timely availability of products, materials, and services that are needed to meet current national defense and emergency preparedness requirements with minimal interference to the conduct of normal business activity. Second, it provides an operating structure to support a timely and comprehensive response by U.S. industry in the event of a national security emergency.

Under Executive Order 12919 of 1994, the Department of Commerce administers this system in accordance with the priorities and allocations provisions of the DPA. Those provisions provide authority for requiring U.S. companies to accept and perform contracts or orders necessary to meet national defense and civil emergency needs. They also provide authority for managing the distribution of scarce and critical materials in an emergency.

The DPAS is not used solely for defense items and military crises. It also may be implemented to meet urgent requirements for energy and law enforcement programs. Under the DPAS, the Department of Commerce delegates the authority to use the system to obtain critical products, materials, and services to meet approved program requirements of several Federal agencies, including the Departments of Defense and Energy. To implement this authority, the Department of Defense and the

other agencies—called Delegate Agencies—place what are known as "rated orders" on essentially all procurement contracts with industry. The prime contractors, in turn, place "rated orders" with their subcontractors for parts and components down through the vendor base. The "rated orders" notify the contractors that they are accepting contracts with the U.S. government that must be given priority, as necessary, over unrated orders to meet the delivery dates of the rated orders.

In the vast majority of these cases, the procuring Federal agency and the contractor quickly come to mutually acceptable terms for priority production and delivery. If the company and the delegated Federal agency cannot reach such agreement, the Department of Commerce, as the primary liaison with U.S. industry, plays a crucial role in resolving the issue. The Department provides "Special Priorities Assistance" to resolve critical production bottlenecks for many military and national security emergency requirements. At the same time, the Department works to ensure that the production requirement does not pose an undue or unfair burden on the supplier company. I would like to share some examples of the Department's work in this important area.

A. Operation Desert Shield and Desert Storm

One of the best examples of the Commerce Department's work was its support of U.S. and allied requirements for Operation Desert Shield and Desert Storm in 1990–1991. The Commerce Department worked closely with U.S. industry and the Department of Defense on 135 Special Priorities Assistance cases to assure timely delivery of critical items, such as avionics components for aircraft, precision guided munitions, communications equipment, and protective gear for chemical weapons. Due to the Commerce Department's involvement, in the majority of cases delivery schedules were reduced from months to weeks or from weeks to days.

B. Coalition Action in the Balkans

The North Atlantic Treaty Organization (NATO) coalition action in the Balkans resulted in a number of instances of industrial bottlenecks for critical equipment. Starting in 1993 and continuing through 2000, the Department of Commerce worked 73 Special Priorities Assistance cases in support of U.S. forces, allied forces, and NATO command and control requirements. Although most of these cases pertained to NATO acquisition in the United States of communication and computer equipment, Special Priorities Assistance under DPAS also was used to expedite the production and delivery of such military items as antennas, positional beacons, and precision guided munitions for both U.S. and allied forces.

C. Federal Bureau of Investigation

In 1995, the Federal Bureau of Investigation (FBI) urgently required delivery of special communications equipment to meet the needs of a critical and classified national defense related antiterrorist law enforcement program. Accordingly, Commerce staff worked with 4 contractors and their lower tier vendors to achieve timely delivery of parts and components to meet the FBI deployment requirement in the face of conflicting customer demands.

D. United Kingdom's Royal Air Force (RAF) Apache Longbow Helicopters

The Commerce Department's involvement in the DPAS supports not only the requirements of U.S. armed forces, but also the requirements of our allies. The Department is currently working with U.S. industry, the Department of Defense, and the United Kingdom's Ministry of Defence to meet a Royal Air Force requirement for Apache Longbow helicopters. Without the DPAS, U.S. firms supplying transponders and Hellfire missile launchers would not be able to meet RAF requirements while also meeting urgent U.S. Army requirements. It is important to note that the Department of Commerce will not take action on behalf of an allied government unless the Department of Defense determines it is in the U.S. national interest to do so.

As demonstrated by these examples, the DPAS provides the means for clearing any commercial bottlenecks that might otherwise interfere with meeting the critical production and service requirements of the U.S. armed forces, other Federal agencies, NATO, and our close allies.

II. Defense Trade Offsets

Pursuant to section 309 of the DPA, the Department of Commerce provides Congress with an annual report on the impact of offsets in defense trade. Defense trade offsets are industrial compensation practices required as a condition of purchase in either government-to-government or commercial sales of defense articles and/or services, as defined by the International Traffic in Arms Regulations. For example, a foreign government may agree to purchase fighters from an American company

but could insist that the engines for the jets be produced in the foreign country using local suppliers. We believe that offsets are economically inefficient when the foreign customer is basing the purchase decision on something other than the quality of the product or service being provided. Moreover, offsets do a disservice to the defense supplier base in the United States by transferring work and technology overseas. Although any unilateral action on offsets could have a negative impact on the competitiveness of our prime contractors in world markets, we believe that we should address the issue of offsets in bilateral and multilateral settings.

The Department of Commerce's annual report on defense trade offsets has become an integral part of the U.S. government's effort to monitor this critical issue for the U.S. defense industry. We have just published our fiscal year 2000 report. On the basis of the trends that we have identified through these reports, a Presidential Commission has been established to investigate more formally the economic and competitiveness effects of offsets on U.S. prime contractors and their suppliers.

III. Defense Industrial Base Studies

Under section 705 of the DPA and Executive Order 12656 of 1988, the Department of Commerce conducts analyses and prepares reports on individual sectors of the defense industry. These studies are either self-initiated or requested by the Armed Services, Congress, or industry. The studies provide a comprehensive view of specific sectors within the U.S. defense industrial base, and they gauge the current capabilities of these sectors to provide defense items to the U.S. military services. The studies provide detailed data that are unavailable from other sources.

To give you a recent example of one of these studies, the Department of Commerce has just published a detailed assessment of the shipbuilding and repair industry in the United States. This is one in a series of analyses related to the maritime industry that were requested by the U.S. Navy. We understand that the Navy is pleased with the quality and thoroughness of the report and looks forward to future cooperative efforts. In another instance, the U.S. Air Force requested the Department of Commerce to conduct an assessment of the ejection seat sector in the United States. Several of the recommendations in that report have been implemented by the Air Force and industry.

IV. Committee on Foreign Investment in the United States (CFIUS)

The Committee on Foreign Investment in the United States (known as "CFIUS") was originally established by Executive Order 11858 in 1975. The Department of Commerce is a member of the Committee, which is chaired by the Department of Treasury. In 1988, pursuant to Executive Order 12661, the President delegated to CFIUS certain of his responsibilities under section 721 of the DPA (known as the "Exon-Florio" provision). Exon-Florio provides for a national security review of foreign mergers and acquisitions of U.S. companies. The intent of Exon-Florio is to provide a mechanism to review and, if the President finds necessary, to suspend or prohibit a foreign direct investment that threatens the national security, but not to discourage foreign direct investment generally. The Department of Commerce's contribution to the CFIUS process includes providing a defense industrial base and export control perspective to the CFIUS reviews. In the last year, there have been several contentious CFIUS cases. Although I cannot address the details of these cases because of the confidentiality extended to CFIUS reviews by Exon-Florio, the Department of Commerce was actively involved in each of the reviews, focusing particular attention on the national security impact of the acquisition. In this period of rapid globalization, continuation of this interagency review process is vital.

In sum, the DPA provides essential authority for a variety of important programs at the Department of Commerce. My remarks illustrate the importance of the DPAS not only to our military services, but also to NATO and our close allies that operate our weapons systems. The Department of Commerce, in its role of primary liaison to U.S. industry, has been able, through DPAS, to ensure timely delivery of products and services essential to United States and allied forces with minimal impact upon normal commercial activities.

The DPA also affords the Department of Commerce the opportunity to assess fully the economic efficiency of defense trade offsets and the national security implications of international consolidation of the defense trade industry. In addition, the DPA enables the U.S. government to monitor the U.S. defense industrial base in this era of globalized markets, coalition military campaigns, and electronic battlefields. For all these reasons, the Department of Commerce fully supports extending the current Defense Production Act for at least a 3-year period. Thank you.

PREPARED STATEMENT OF MICHAEL D. BROWN

GENERAL COUNSEL, FEDERAL EMERGENCY MANAGEMENT AGENCY

JUNE 27, 2001

Good afternoon, Mr. Chairman. I am Michael Brown, General Counsel of the Federal Emergency Management Agency. FEMA Director Joe M. Allbaugh asked me to represent him today, and regrets that he is unable to be here.

FEMA is pleased to appear before you to discuss the reauthorization of the Defense Production Act—the Nation's major statute for mobilization readiness. As you know, the nonpermanent provisions in Titles I, III, and VII will expire on September 30. The expiration of these provisions could have a severe impact on the Nation's emergency resource preparedness to meet threats to our national security—including a terrorist weapon of mass destruction. We may also need to use DPA authorities to respond to other catastrophic civil emergencies.

The Administration views the possibility of such expiration as disruptive to ongoing programs under the Act. FEMA requests that a reauthorization of at least 3 years be considered by the Congress to ensure the continuation of these programs.

The President has delegated a number of responsibilities to the FEMA Director for the coordination and support of the Act under Executive Order 12919. These responsibilities include the duties to:

- Serve as an advisor to the NSC on DPA authorities and national security resource preparedness issues;
- Provide central coordination;
- Develop guidance and procedures under the DPA that are approved by the NSC;
- Attempt to resolve issues on resource priorities and allocations;
- Make determinations on the use of priorities and allocations for essential civilian needs supporting the national defense; and
- Coordinate the National Defense Executive Reserve (NDER) program activities of departments and agencies in establishing NDER units and provide guidance for recruitment, training and activation.

There are 8 Federal departments and agencies with units of industry reservists available for use in emergencies. These reservists could not be used if the Congress does not reauthorize the DPA.

FEMA supports the NSC in coordinating the updating of Executive Orders relating to the DPA and supports interagency efforts such as the President's Report to the Congress on the Modernization of the Defense Production Act submitted in 1997. In 1997 FEMA aided the Federal Bureau of Investigation in obtaining equipment in their counter intelligence role.

At the Federal level, FEMA is the lead agency for coordinating domestic hazards consequence management. We work with other departments and agencies to ensure that the Federal Government is prepared to respond to the consequences or potential consequences of natural and human-caused hazards, including terrorist incidents, as they relate to public health, safety, and property. DPA authorities are available to support consequence management—specifically those all-hazards emergency preparedness activities defined under Title VI of the Robert T. Stafford Disaster Relief and Emergency Assistance Act (the Stafford Act).

The term "emergency preparedness" means all those activities and measures designed or undertaken to:

- Prepare for or minimize the effects of a hazard upon the civilian population, such as procurement and stockpiling of materials and supplies;
- Respond to the hazard; and
- Recover from the hazard.

To date, FEMA has not used DPA authorities in its domestic consequence management role. When confronted with a major disaster or emergency declared by the President, our first recourse is the Stafford Act. We intend to use DPA authorities for catastrophic disasters when resources to respond to such disasters and emergencies are unavailable in a timely manner.

Circumstances that might warrant use of DPA Title I priorities and allocations authorities include a massive earthquake or the use of a terrorist weapon of mass destruction. Such events could have severe impacts on our population and our national security that might not be met in the normal course of business in the marketplace and could warrant use of the Defense Production Act to effect timely delivery of needed materials and resources.

One of Director Allbaugh's priorities is to have FEMA, in coordination with our Federal, State, and local partners, develop stand-by plans that can be used to respond to and recover from large catastrophic disasters. A key authority to obtain

resources in such circumstances could be the use of priority orders authorized under Title I of the DPA. Failure to reauthorize the Act would severely hamper Federal efforts to respond and recover with required resources if they were not available in time to support the health and well being of the affected population.

In this context FEMA's new Office of National Preparedness will be coordinating and integrating Federal preparedness activities in support of developing and building the national capability to manage the consequences of a terrorist incident involving a weapon of mass destruction. As part of this integration effort, the Office will be looking at the range of available authorities that can support terrorism preparedness and response, including DPA authorities as appropriate.

In summary, the DPA's linkage to the Stafford Act ensures the availability of needed resources when the Nation is facing a catastrophic disaster whether natural or manmade. We urge the Congress to reauthorize the DPA before its expiration on September 30. I thank you for the opportunity to appear today. I would be pleased to answer any questions you may have.

PREPARED STATEMENT OF ERIC J. FYGI

DEPUTY GENERAL COUNSEL, U.S. DEPARTMENT OF ENERGY

JUNE 27, 2001

Mr. Chairman and Members of the Subcommittee, I am pleased to appear before the Subcommittee in response to its request for testimony by the Department on the reauthorization of the Defense Production Act of 1950. It may be informative in addressing the reauthorization of the Defense Production Act to describe the most recent use of the Defense Production Act in responding to an energy crisis situation. I am referring to the Department's use, as directed by former President Clinton, of the Defense Production Act as a complement to the emergency provisions of the Natural Gas Policy Act in responding to actual and threatened interruptions of natural gas supplies in northern and central California in January of this year.

The circumstances that gave rise to the interruption of natural gas supplies in northern and central California actually began with the cumulative effects of electricity sales within the State under California's 1996 electricity restructuring legislation. Under that structure State-regulated electric utilities were required to sell electricity to their customers at frozen rates that could not be adjusted upward to reflect increased acquisition costs of wholesale electric power. At the same time, the State required Pacific Gas and Electric Company ("PG&E") and other State-regulated electric utilities to purchase their electricity supplies in the day-ahead or real time spot market (in contrast to long-term contracting, which permits hedging), provided for partial divestiture of the utilities' fossil generation assets, and required utilities to sell their electricity into the Power Exchange rather than use it to serve their customers. In addition, growth in electricity demand far outpaced growth in electricity supply. Between 1996 and 1999, demand in California rose 5,500 megawatts (MW), while supply rose only 670 MW. This combination of factors put the utilities in the position of buying wholesale power for as much as 30 cents per kilowatt-hour, while only being allowed to sell it for 3 cents.

Beginning in May 2000, State-regulated electric utilities began to accumulate huge debts in the form of unrecovered wholesale power costs as a result of the rate freeze. These unrecovered wholesale power costs significantly weakened the financial health of the utilities and, in many cases, the utilities approached insolvency. PG&E's debts alone totaled $6.6 billion. The reluctance of electricity generators and marketers to sell to PG&E and Southern California Edison, the other major State-regulated electric utility that accumulated large unrecovered wholesale power costs, deepened as the financial condition of the utilities worsened. In order to prevent loss of electricity supplies to the customers of the utilities, then-Secretary of Energy Richardson issued an emergency order under the Federal Power Act on December 14, 2000, directing certain electricity generators and marketers to continue to sell electricity upon request by the California Independent System Operator, a nonprofit corporation established by the 1996 California electricity restructuring law charged with operation of the transmission system and assuring system reliability in California. This type of emergency order ultimately was extended to 3:00 am EST on February 7, 2001.

The poor financial condition of PG&E also led some natural gas suppliers to terminate sales to the utility, out of concern that the losses the utility was incurring in its electricity operations would lead to insolvency, notwithstanding the fact that PG&E's gas operations themselves could recover costs under its tariff. Unlike South-

ern California Edison, PG&E is both a gas and electric utility. On January 9, 2001, one supplier, which supplied approximately 14 percent of PG&E's core gas supplies, terminated sales to PG&E. Other gas suppliers soon followed suit and still others threatened to stop deliveries absent prepayments or credit guarantees. About 25 percent of PG&E's January baseload supply of natural gas was terminated and substantial additional volumes were threatened.

PG&E serves 3.9 million "core" gas customers in California, both residential consumers and small businesses. PG&E also transports natural gas to about 5,000 "noncore" customers, including industrial consumers and electricity generators. If PG&E experienced a shortage in gas deliveries, it would have to increase withdrawals from gas already in storage and divert gas from noncore customers. Diversion from noncore customers would exacerbate the California electricity shortage, since two-thirds of PG&E's noncore gas is used for electricity generation.

PG&E and Southern California Edison first sought redress at the State level by applying to the California Public Utilities Commission for retail electricity rate increases. On January 4, 2001, the California Public Utilities Commission increased retail electricity rates by a surcharge of one cent a kilowatt-hour among its classes of customers. It did so for a period of 90 days, and did not otherwise alter the rate freeze under which PG&E and Southern California Edison were operating. PG&E also sought action from the State to prevent a loss of gas supplies. PG&E asked the California Public Utilities Commission for emergency authorization to draw on the gas supplies of the other major gas utility in the State. The California Public Utilities Commission never acted on this request.

On January 10, 2001, PG&E and its parent filed a Form 8–K with the Securities and Exchange Commission in which they announced suspension of dividend payments and postponement of release of financial results for the fourth quarter of 2000. The stated reason for postponing release of financial results was that the outcome of then on-going State and Federal efforts involving the California electricity market could result in measures that "significantly and adversely affect" PG&E Corporation's financial results.

Beginning the first week in January, the Department was advised by PG&E's General Counsel that debt rating agencies had reacted negatively to the California Public Utilities Commission's January 4 Order, and that if PG&E's outstanding debt were reduced to junk status that event would constitute a default under PG&E's various natural gas supply contracts. Were that event to occur it would accelerate the payment obligation of all of PG&E's natural gas supply contracts. While we understood that at the time PG&E had acquiesced in prepaying some of its natural gas suppliers, the normal payment schedule of PG&E was that its contracts required payment in full on the 25th day of each month for the entire prior month's deliveries of natural gas to PG&E for sale to its gas customers. While PG&E's tariff with the California Public Utilities Commission enabled it to recover the full amount of increased acquisition costs for natural gas resold by PG&E (unlike the case for electricity), because of PG&E's precarious operating revenue posture stemming from the electricity market, PG&E indicated that it could not continue to purchase the needed volumes of natural gas if it were required to prepay for them.

At about the same time, beginning January 9, 2001, then-Treasury Secretary Summers and then-Energy Secretary Richardson participated in extensive meetings that included the Governor of California, California legislative leaders and the President of the California Public Utilities Commission, the CEOs or Presidents of the major California electricity suppliers, and the CEOs of the California investor-owned utilities or their parents. While the objective of these meetings was to assist the State of California in formulating a solution to the evolving situation, no such solution was announced.

On January 12, 2001 the CEO of PG&E formally requested President Clinton to invoke emergency authorities in order to assure continuity of natural gas supplies through PG&E to its service territory in northern and central California. That letter was accompanied by an affidavit executed the same day by the Chief Financial Officer, Treasurer and Senior Vice President of PG&E that described in detail the circumstances giving rise to the threatened interruption of natural gas supply through PG&E to northern and central California. On January 13, 2001 Governor Davis sent a letter to President Clinton in which the Governor described his inquiry into the circumstances, his finding that there was an "imminent likelihood that natural gas supplies in northern and central California will be interrupted," and requested the assistance of the President and the Secretary of Energy on an urgent basis.

On January 15, 2001 then-Deputy Energy Secretary Glauthier conducted a telephone conference that included operational executives of PG&E in order to ascertain further the logistical and operational circumstances that necessitated immediate action at the Federal level. On January 16, 2001 Reuters reported that Standard &

Poor's had downgraded PG&E's debt to "low junk" status. President Clinton's instructions to the Secretary of Energy, and the Secretary of Energy's accompanying Order to PG&E and its natural gas suppliers, were issued on January 19, 2001. As the text of each document indicates, their issuance was based not only on the emergency provisions of the Natural Gas Policy Act of 1978, but also on the Defense Production Act of 1950. I now turn to the reasons that prompted the Department to formulate this approach.

When it appeared in early January that it might prove necessary to formulate emergency orders for continued delivery of natural gas through PG&E, we first examined the emergency provisions of the Natural Gas Policy Act of 1978, 15 U.S. C. 3361–3364. Those provisions appeared useful in that they authorized designation of continued use of natural gas for electricity generation as a "high-priority use" in an emergency, and authorized specification by the Federal Government of the "terms and conditions" including "fair and equitable prices" for natural gas delivered under an order. The ability to determine that continued use of natural gas was a "high-priority use" under the Natural Gas Policy Act was important because, without such Federal action, under California law, any reduction in gas volumes available to PG&E as merchant impairing its ability to serve its "core customers" (residences and small businesses) would result in mandated redirection of gas volumes delivered through PG&E (but not owned by it) destined for noncore customers, including most significantly electricity generators. Were such redirection to occur it would have further reduced the volumes of natural gas available for electricity generation in California.

Despite the technical utility of section 302 of the Natural Gas Policy Act, 15 U.S. C. 3362, in these respects, we remained concerned that it only would "authorize" purchase, rather than also to require deliveries, of natural gas to enable PG&E to continue to distribute sufficient volumes of natural gas. During January PG&E advanced arguments asserting that the allusion to an "order" in section 302 suggested that it embraced an ability to impose a supply mandate. Based on textual analysis of the Natural Gas Policy Act we remained unpersuaded on this point. In forming our view of this question we also consulted with an attorney of the Federal Energy Regulatory Commission who had been designated by the Commission's General Counsel to aid us in our examination of this question. Our textual analysis coupled with that of the Federal Energy Regulatory Commission attorney, together with our understanding of the provenance of section 302 as having had the original objective simply of permitting emergency sales into interstate commerce by nonjurisdictional gas producers without becoming subject to then-existing wellhead price controls, prompted us to conclude that the Natural Gas Policy Act's emergency provisions, standing alone, would not suffice if the Federal Government were to mandate continuity of natural gas deliveries through PG&E to all of its service territory in northern and central California.

We considered whether the Defense Production Act provided the authority to complement the emergency provisions of the Natural Gas Policy Act such that the entities (largely resellers and not producers) that had recently provided PG&E with natural gas could be directed to continue to make similar volumes available to PG&E. We concluded that the Defense Production Act would provide this authority.

Title I of the Defense Production Act authorizes the President to require the priority performance of contracts or orders in certain circumstances. Under section 101(a), 50 U.S. C. App. 2071(a), the President may require performance on a priority basis of contracts or orders that he deems "necessary or appropriate to promote the national defense." In determining what the national defense requires, the President may consider the potential impact of shortages of energy supplies. In the Energy Security Act Congress specifically designated energy as a "strategic and critical material" within the meaning of the Defense Production Act and also added language to its Declaration of Policy that establishes a link between assuring the availability of energy supplies and maintaining defense preparedness. The Defense Production Act's Declaration of Policy, 50 U.S. C. App. 2062(a)(7), states:

> [I]n order to ensure national defense preparedness, which is essential to national security, it is necessary and appropriate to assure the availability of domestic energy supplies for national defense needs.

PG&E's customer base in northern and central California includes a number of defense (including "space," as the term "defense" is defined in the Defense Production Act) installations and defense contractors that use natural gas and electricity and that clearly would be adversely impacted by interruption of natural gas service. Continuity of supply to these facilities was threatened in the same fashion as other industrial natural gas consumers in PG&E's service territory.

Section 101(c) of the Defense Production Act, 50 U.S. C. App. 2071(c), authorizes the President to require priority performance of contracts or orders for goods to maximize domestic energy supplies if he makes certain findings, including that the good is scarce and critical and essential to maximizing domestic energy supplies. In the situation existing in California in mid January, natural gas supplies would have become acutely scarce had the withholding by PG&E's suppliers continued and expanded to more suppliers than those that already had terminated deliveries. Moreover, continuity of natural gas supply is critical and essential in PG&E's service area to electric energy generation, petroleum refining, and maintaining energy facilities. These factors seemed directly to bear on the terms of section 101(c) of the Defense Production Act relating to continuity of energy production.

Accordingly, we structured the emergency natural gas order to include the supply obligation authorized by the Defense Production Act. Our understanding of the Defense Production Act regime was that it is broad enough to embrace mandates for priority performance of new orders to vendors, as well as priority performance of existing contracts. Thus this authority fit well in a transactional sense in which some vendors' contracts to supply gas might have expired by their terms just before the order was issued.

This aspect of the Defense Production Act regime permitted the Department to impose a temporary supply assurance for natural gas to northern and central California comparable to that done with the electricity orders for the area of the State served by the California Independent System Operator by the Department's prior orders under section 202(c) of the Federal Power Act. The emergency natural gas order issued by former Secretary of Energy Richardson on January 19, 2001 and extended by Secretary Abraham on January 23, 2001, was directed just to the group of suppliers that had provided PG&E natural gas on commercial terms during the 30-day period prior to issuance of the order. This approach was chosen as the least intrusive means that would achieve the public health and safety and defense preparedness objectives of continuing for the near term natural gas supplies into PG&E's service area. The order is best understood as an emergency, temporary action designed to afford California the opportunity to abate the emergency by its necessary further actions.

As a result of the Department's emergency orders natural gas supplies continued to flow through PG&E into northern and central California, averting a natural gas supply crisis. Despite the apprehensions about payment by PG&E that had prompted the threatened interruptions of natural gas deliveries, every natural gas supplier named in the emergency orders was paid in full by PG&E on the schedule required by those orders.

Prior to its use in the emergency natural gas supply orders described above, the Department used section 101(a) of the Defense Production Act from time to time during the accelerated weapons production period in the 1980's, and section 101(c) was used in the 1970's and again the in the 1980's and early 1990's to facilitate petroleum and natural gas production development of the Alaskan North Slope.

Whether the Defense Production Act authorities placed in the President might be useful in addressing energy needs of the country in the future would be highly fact-dependent. Because the Act's use would require a fact-dependent judgment, it would be difficult to predict whether circumstances might arise that would prompt the President to conclude that direct Federal action under this authority was warranted. While I do not expect us to confront in the near future an event and set of circumstances as peculiar as the emergency in California, there are other instances that our experience indicates are very plausible in which these authorities would be of crucial importance.

For example, if world circumstances were such that we had to draw down the Strategic Petroleum Reserve, and coincident with that realization and direction from the President to take that action there was a significant breakdown in the Strategic Petroleum Reserve facilities, that would be the type of circumstance where, if it were urgent to replace scarce and backlogged specialized pumps and other apparatus, we could rely upon the Defense Production Act to bring the facility back online in an operational sense as promptly as possible. Absent the Defense Production Act, it would be exceedingly difficult to persuade vendors to put our order at the head of the line for fear of third-party contract liability that they otherwise might expose themselves to, even if they were otherwise willing to cooperate with the Department in the interests of the country.

In conclusion, the Department fully supports extending for 3 years these Defense Production Act authorities which have proven so useful in a variety of circumstances in making a contribution to the national security, including energy security. This concludes my prepared statement. I will be pleased to respond to any questions the Subcommittee may have.

PREPARED STATEMENT OF DELORES M. ETTER

ACTING DIRECTOR, DEFENSE RESEARCH AND ENGINEERING
U.S. DEPARTMENT OF DEFENSE

JUNE 27, 2001

Good morning, Mr. Chairman and Members of the Committee. I appreciate the opportunity to share with you the Department of Defense (DoD) views regarding the Defense Production Act (DPA) and the role it plays in helping to obtain the goods and services needed to promote the national defense. Although enacted originally in 1950, the Act provides statutory authorities still relevant and necessary for the national defense in the 21st century. I also want to express the administration's support for reauthorizing the Act through September 30, 2004.

Let me start by saying a few words on why the Defense Production Act is important to the Department of Defense. A strong domestic industrial and technology base is one of the cornerstones of our national security. The Act provides the DoD tools required to maintain a strong base that will be responsive to the needs of our armed forces. It provides the President the authority to (1) establish, expand, or maintain essential domestic industrial capacity; (2) direct priority performance of defense contracts and allocate scarce materials, services, and industrial facilities; and, suspend or prohibit a foreign acquisition of a U.S. firm when that acquisition would present a threat to our national security. The authorities in this Act continue to be of vital importance to our national security. My testimony today focuses on the three remaining provisions of the original Defense Production Act, namely Title I, Title III, and Title VII.

Title I

Title I (Priorities and Allocations) of the Defense Production Act provides the President the authority to:

1. require preferential performance on contracts and orders, as necessary, to meet approved national defense and emergency preparedness program requirements; and
2. allocate materials, services, and facilities as necessary to promote the national defense in a major national emergency.

Executive Order 12919 delegates these authorities to the Federal Departments and Agencies. The Department of Commerce (DoC), is delegated responsibility for managing industrial resources. To implement this authority, DoC administers the Defense Priorities and Allocations System (DPAS). The DPAS:

1. establishes priority ratings for contracts;
2. defines industry's responsibilities and sets forth rules to ensure timely delivery of industrial products, materials and services to meet approved national defense program requirements; and
3. sets forth compliance procedures.

The DoC has delegated to DoD authority under the DPAS to:

1. apply priority ratings to contracts and orders supporting approved national defense programs. (However, DoD is precluded from rating orders for end items that are commonly available in commercial markets and for items to be used primarily for administrative purposes, for example, office computers); and
2. request DoC provide Special Priorities Assistance (SPA) to resolve conflicts for industrial resources among both rated and unrated (for example, nondefense) contracts and orders; and to authorize priority ratings for allied nation defense orders in the United States when such authorization furthers U.S. national defense interests.

Except as noted above, all DoD contracts are authorized an industrial priority rating. DoD uses two levels of rating priority, identified by the rating symbols "DO" or "DX." All DO rated orders have equal priority with each other and take preference over unrated orders. All DX rated orders have equal priority with each other and take preference over DO rated orders and unrated orders. If a contractor cannot meet the required delivery date because of scheduling conflicts, DO rated orders must be given production preference over unrated orders and DX rated orders must be given preference over DO rated orders and unrated orders. Such preferential performance is necessary even if this requires the diversion of items being processed for delivery against lower rated or unrated orders. Although the DPAS is largely self-executing, if problems occur, the contractor or the DoD can request the DoC provide SPA to resolve the problem.

During peacetime, the DPAS is important in setting priorities among defense programs that are competing for scarce resources and backlogged parts and subassem-

blies. Delayed deliveries to producers of weapon systems have consequences in terms of system cost and ultimately on the readiness of operational forces. DPAS gives DoD an opportunity to prioritize deliveries and minimize cost and schedule delays among DoD orders and for allied nation defense procurements in the United States. For example:

1. U.S. DoD: Production resource conflicts for canopy transparencies from Sierracin Aerospace impacted program schedules for the F–22, F–18A/B/C/D, and F–18E/F aircraft. Navy and Air Force DPAS and program office personnel met with the contractor, evaluated production resource shortfalls and delivery conflicts, and made delivery modifications that minimized program delays.

2. NATO: The German and Belgian Air Force, on behalf of NATO's Tactical Leadership Program, were unable to obtain global positioning system navigational processors from Rockwell Collins in a timely manner, adversely impacting pilot training. DoD/DoC authorized ratings authority that enabled the contracts to be filled in advance of lesser priority US DoD orders.

3. United Kingdom (U.K.): GKN Westland Helicopters experienced delays in receiving identification friend or foe transponders from Raytheon Systems Company that were needed for U.K. WAH–64 Apache helicopters. DoD/DoC authorized GKN Westland to use a DO rating priority that permitted Raytheon to ship the transponders sooner than would have been possible without the rating authority, which allowed and permit GKN Westland to meet its production delivery requirements to the U.K. Ministry of Defence.

In the event of conflict or contingency, however, the DPAS becomes indispensable. While DoD has used Title I since the 1950's, recent history, including that associated with Operation Desert Shield/Storm, Bosnia, and Kosovo, illustrates its continued importance. Title I authorities proved invaluable during Operation Desert Shield/Storm and ensured that industry provided priority production and shipment of essential items urgently needed by the coalition forces. At the request of DoD, DoC formally took action to provide SPA in 135 cases during Operation Desert Shield/Desert Storm. For example:

1. Global Positioning System Receivers: When demand for these receivers outstripped the capacity of suppliers, DoD/DoC used DPAS to expedite shipments and to provide available systems to units in the coalition force that had the most urgent requirement.

2. Activated Charcoal for Gas Masks: When the demand for activated charcoal filters for gas masks outstripped the production capacity of Calgon Corporation (the sole producer of activated charcoal filters for military use gas masks), DoD/DoC used DPAS to direct Calgon to ship all charcoal filters produced to meet military requirements.

3. Search and Rescue Radios: Motorola, the producer of these radios, had closed its production line and anticipated it would take several months to restart production; vendor supply of component parts was the pacing item. Using its DPAS authority, DoC worked with Motorola's supplier base and reduced the time to restart production of the radios by more than half.

Even more recently, since 1995, DoD/DoC has used SPA on more than 100 occasions to resolve industrial conflicts among competing U.S. defense orders and to permit NATO and specific allied nations to obtain priority contract performance from U.S. suppliers. These SPA cases can be categorized in two ways:

1. Wartime vs. Peacetime Support: 68 percent of the cases supported "wartime" needs (50 percent Bosnia and 18 percent Kosovo) for items such as Satellite Communication (SATCOM) and walkie-talkie radios, secure facsimile machines, Joint Direct Attack Munitions (JDAMs), and computer equipment for NATO command and control infrastructure. 32 percent of the cases supported "peacetime" requirements.

2. U.S. vs. nonU.S. Support: 37 percent of the cases supported U.S. defense requirements (32 percent for DoD and 5 percent for defense-related activities of NASA, NSA, and the FBI), 47 percent for NATO (NATO monies used), 9 percent for the United Kingdom, 3 percent for Canada. In addition, there were 2 cases for Israel, and 1 case each for Japan and Germany.

The authorities contained in Title I that permit DoD to provide preferential treatment for foreign defense orders in the United States when such treatment furthers U.S. national defense interests are increasingly important. Among the consequences of globalization and industrial restructuring are the creation of multinational defense companies and an increasing degree of mutual defense interdependence. Reciprocal industrial priorities systems agreements with our allies encourage them to acquire defense goods from U.S. suppliers, promote interoperability, and simulta-

neously provide increased assurance that the DoD's nonU.S. defense suppliers will be in a position to provide timely supplies to DoD during both conflict/contingency situations and peacetime.

Such reciprocity considerations have been a topic of discussion within NATO for some time. The DoC has the U.S. lead to develop and negotiate a NATO-wide agreement to provide reciprocal priorities support within the alliance.

In addition to a NATO-wide agreement we are exploring formal bilateral agreements with key allies of the United States. These provide an opportunity to establish stronger government-to-government agreements for reciprocal priority support, more quickly. The United States has a longstanding bilateral priorities support agreement with Canada. Within the past year, DoD representatives have had discussions about such bilateral agreements with United Kingdom, German, French, Italian, Dutch, Norwegian, and Swedish goveniment representatives. As a matter of fact, DoD and United Kingdom Ministry of Defence representatives now are negotiating a formal bilateral agreement that would commit each nation to establish and maintain a reciprocal priorities system; and provide the other nation reciprocal access to that system.

DPA Title I provisions are an important tool in DoD's arsenal. It would be very difficult for DoD to meet its national security responsibilities without that tool. Now, I will turn my attention to Title III of the Defense Production Act.

Title III Program

The primary objective of the Title III Program is to work with U.S. industry to strengthen our national defense posture by creating or maintaining affordable, and economically viable production capabilities for items essential to our national security. The Title III Program meets this objective through the use of financial incentives to stimulate private investment in key production resources. These incentives include sharing in the costs of capital investments, process improvements and material qualification, and providing when necessary, a purchase commitment that will ensure a market for their product. Through these incentives, domestic industry is encouraged to take on the business and technical risks associated with establishing a commercially viable production capacity.

The focus of the Title III Program is on the transition of emerging technologies that will provide technological superiority on the battlefield and support defense wide programs. The Title III partnership with industry ensures DoD access to critical technologies, usually much sooner than would otherwise occur.

In addition to establishing production capacity, Title III helps to improve the quality, and reduce the acquisition and life cycle cost of defense systems and improves defense system readiness and performance by promoting the use of higher quality, lower cost, technologically superior parts and components.

By law, Title III projects cannot be initiated until a presidential determination has been made and Congress has been notified. The presidential determination verifies that:

1. the material shortfall being addressed by the Title III project is essential for national defense;
2. domestic industry can not or will not on their own establish the needed capacity in a timely manner;
3. Title III is the most cost effective or expedient method for meeting the need; and
4. defense and commercial demand exceed current domestic supply.

Our recent report to Congress entitled "Annual Industrial Capabilities Report to Congress" (January 2001) affirmed Title III's unique importance as one of the programs we execute to maintain our industrial readiness. Title III is a key element in our Industrial Capabilities Improvement Activities.

Title III Projects

Title III projects transition new materials and technologies from research and development to production. These projects reduce the costs and facilitate the insertion of advanced technologies by improving the capabilities of our defense industrial base.

Without Title III, the insertion of these technologies would be delayed for many years. Title III reduces this time by first, eliminating market uncertainties and reducing risks that discourage potential producers from creating new capacity and potential users from incorporating new materials in their products. Second, Title III financial incentives create more efficient, lower cost production capabilities which reduces prices and increases demand. Third, Title III projects generate information about the performance characteristics of new materials and promote dissemination of this information to the design community, which would otherwise lack sufficient

knowledge to incorporate these materials into defense systems. Fourth, Title III projects support testing and qualification of new materials in defense applications, reducing the delay and cost that might otherwise discourage consideration of new materials by defense programs.

Current Program

There are currently eight active Title III projects and DoD is initiating a new thrust into radiation hardened electronics. This initiative will establish a domestic production capacity for radiation hardened, high-performance electronics materials and components to support the National Missile Defense Program and other strategic space systems.

These projects, plus recently completed projects, address a variety of advanced materials and technologies. These include:

1. electronic materials and devices, such as gallium arsenide, indium phosphide, high-purity silicon, silicon carbide, silicon on insulator, and power semiconductor switching devices;
2. structural materials, including discontinuous reinforced aluminum, aluminum metal matrix, and titanium metal matrix composites.

The advanced electronic materials supported by Title III are enabling technologies, without which potential advances in microelectronics would be far more limited. These materials offer advantages in terms of faster device performance, greater resistance to radiation and temperature, reduced power requirements, reduced circuit size, increased circuit density, and the capability to operate at higher frequency levels. Advances in electronic materials enable new capabilities for defense systems and improvements in old capabilities.

The new structural materials supported by Title III generally offer significant improvements in terms of strength, weight, durability, and resistance to extreme temperatures. These benefits are particularly important in aerospace applications. Lighter-weight components in aircraft and missiles reduce fuel consumption and increase range, payload, and maneuverability. Increased durability and reliability of aircraft structures reduce inspection, maintenance, repair, and replacement requirements, improve force readiness, and extend system life. Increased strength and enhanced resistance to extreme temperatures enable more powerful engines that increase speed and payload. Continued advances in aerospace technologies would be severely constrained without improved materials to enable these advances.

Title III Success Stories

Two recent Title III projects highlight the benefits of the program.

Gallium Arsenide Wafers

The first was for gallium arsenide semi-insulating wafers. Gallium arsenide is a semiconducting material used in the fabrication of advanced electronic devices. It provides advantages in terms of speed, power consumption, cost, and reliability over more commonly used semiconductor materials, such as silicon. It is also resistant to radiation and is routinely used in "hardened" electronic devices. Electronic devices built on gallium arsenide semiconductors are enabling technologies for a wide variety of defense weapon systems, including radars, smart weapons, electronic warfare systems, and communications. These semiconductors can be found in such systems as the Airborne Early Warning/Ground Integration System (AEGIS), the B–2 Bomber, the Longbow Apache helicopter, fighter aircraft (including F–15, F–16, F–18, and F–22), missiles (including Patriot, Sparrow, and Standard), and various radar systems.

At the outset of this Title III project, the long-term viability of U.S. gallium arsenide wafer supplier base was in doubt. Foreign firms dominated the industry with a 75 percent world market share. U.S. firms were discouraged from competing more vigorously by the relatively small market for these wafers, by the dominant market position of the foreign suppliers, and by the high capital investment required to remain competitive in this market. Foreign firms controlled pricing, availability, and the pace of technological advancement.

With the help of Title III, the U.S. producers made a dramatic turnabout. By 2000 these contractors accounted for 65 percent of wafer sales worldwide. Their combined sales of gallium arsenide wafers grew by nearly 400 percent. In addition, wafer prices dropped by approximately thirty 5 percent. This reduction in wafer prices and improvement in wafer quality resulted in significant reductions in defense costs for critical electronics. More importantly, the performance of dozens of major defense systems was enhanced through the use of gallium arsenide semiconductors. Gallium arsenide components can also be found in a variety of commercial wireless applica-

tions such as cellular phones, direct broadcast television and collision avoidance radar.

Discontinuous Reinforced Aluminum Project

The second Title III project involved Discontinuous Reinforced Aluminum (DRA). This project was also successful, in terms of reduced defense costs, accelerated use of a superior material in defense applications, and improved domestic production capabilities for a high-tech material. DRA is a metal matrix composite that is significantly stiffer, stronger, lighter weight, more wear-resistant and more dimensionally stable than aluminum alloys and many other composite materials. This material has potential applications in virtually every type of aircraft, missile, and armored vehicle.

Prior to the Title III initiative, DRA was produced only in small quantities at high cost. When this Title III project was completed, domestic production capacity was increased by more than 150 percent and the price was reduced by 60 percent from $40 per pound to less than $16 per pound. The reduced price and improved qualities stimulated a substantial increase in demand for this material. DRA is currently being used for F–16 Fighter airframe and engine parts. Use of DRA for the F–16 ventral fin has increased the meantime between failure rate for this structure from 1,450 hours to over 6,000, and will save $60 million in maintenance and repair costs for the F–16 fleet. The savings for this one defense system alone are triple the Title III investment. Pratt & Whitney has forecasted savings of $100 million over the next 10 years from the use of DRA in aircraft engine parts. DRA also flies on the Boeing 777, forming the Fan Exit Guide Vanes in its Pratt & Whitney 4000 engines.

New Projects

During the last year, we began three new projects involving silicon on insulator wafers, laser eye protection, and microwave power tubes.

Silicon-on-Insulator (SOI) Wafer technology, like other semiconductor materials targeted by Title III, offers enhanced performance capabilities, including greater resistance to radiation, reduced power consumption, and faster device performance. The goals of this project are to create a domestic, source for SOI wafers, to improve wafer quality and reduce wafer cost. This will promote insertion of SOI devices into defense systems and expand potential applications to include telecommunications, laptop computers, and automotive and medical diagnostic and control equipment.

The Laser Eye Protection (LEP) project is establishing a large volume, domestic production capacity for near-infrared filters on laser eye protection spectacles and goggles. The modem battlefield is seeing increased use of lasers for target designators, range finders, and target illuminators by both friendly and unfriendly forces. Exposure of the eye to these lasers can cause harm ranging from temporary disorientation to permanent blindness. Over 99 percent of the lasers currently fielded operate in the near-infrared spectrum. Spectacles and goggles with thin-film dielectric near-infrared filters are the best way to protect personnel from the accidental or purposeful exposure to these lasers. Without this project this protection will not be available in a timely manner to our forces in the field.

The Microwave Power Tubes Supplier Base Initiative addresses critical components and materials used in the manufacture of microwave power tubes (MPT). MPTs are vital to the operations of military radar, electronic counter measures, communication systems and satellites. The project goal is to maintain a supplier base for critical components used in the manufacture of MPTs. This project will drive down the production and life cycle costs of MPTs to the DOD, while ensuring continued long-term supply of these critical components. The future effectiveness of U.S. military forces is dependent on access to affordable high power microwave power tubes.

Title VII

Title VII contains general provisions including authorization of appropriations, termination of authorities, definitions, and enforcement, as well as a number of other authorities relating to the defense industrial base and emergency preparedness. Section 721 is of particular importance to DoD.

Section 721 allows the President to suspend or prohibit a foreign acquisition of a U.S. firm when that transaction would present a credible threat to the national security of the U.S. and remedies to eliminate that threat are not available under other statutes. Administration of this section has been delegated to the Committee on Foreign Investment in the U.S. (CFIUS) which is chaired by the Department of the Treasury and includes the departments of Defense, Commerce, State, and Justice as well as several organizations in the Executive Office of the President.

The DoD considers the CFIUS review to be an essential and effective process for analyzing the national security implications of foreign acquisitions of U.S. compa-

nies and resolving issues related to these transactions. While the DoD has its own Industrial Security regulations which are used to review foreign acquisitions and provide a regulatory basis for imposing measures to reduce the risk of unauthorized disclosure of classified information and controlled technology, CFIUS is important in several ways:

First, the DoD Industrial Security regulations which control the granting of facility clearances generally apply only to firms with classified contracts. Therefore, they do not normally cover transactions in which dual use firms with export controlled but unclassified technology are acquired by a foreign firm.

Second, the initial CFIUS review has a 30-day deadline which facilitates an efficient DoD review under its Industrial Security regulations because the Department does not want to approve a transaction under CFIUS unless adequate risk mitigation measures have been agreed to under the Industrial Security regulations.

Third, the CFIUS process is structured to require explicit determinations which are not part of the Industrial Security review. These include whether the acquired firm possesses critical defense technology under development or is "otherwise important to the defense industrial and technology base" as well as development and distribution of a Risk of Technology Diversion Assessment by the intelligence community.

Fourth, the CFIUS review is an interagency process which allows all Federal departments to coordinate their analyses of the national security implications of a review and balance risks of disclosure against the benefits of foreign investment.

The DoD believes the CFIUS review process is working well. The effectiveness of the CFIUS process should be judged on the quality of the risk mitigation measures which the various CFIUS members, including DoD, negotiated during the review process. The threat of a Presidential Investigation prohibiting the transaction is a major incentive for the firms to agree to the risk mitigation measures in a timely fashion. These mitigation measures can include a Special Security Agreement which imposes DoD-approved outside directors, visitation requirements, export licensing compliance procedures and Technology Control Plans as well as National Interest Determinations where the acquired firm holds contracts with Proscribed Information. Other mitigation measures are available under the DoD's Industrial Security regulations as well as the export licensing regulations of the Departments of Commerce and State. CFIUS has provided a timely review of the national security implications of 1,358 foreign acquisitions of U.S. firms since the enactment of section 721 in 1988.

Extension of the DPA

As you know, most provisions of the Defense Production Act are not permanent law and must be renewed periodically by Congress. The Act has been renewed many times since it was first enacted. The current law will expire September 30, 2001. We fully support reauthorizing the Defense Production Act through September 30, 2004.

Conclusion

In summary, the DoD needs the Defense Production Act. It contains authorities that exist no where else and I hope that I have conveyed to you the significant role those authorities play in ensuring our Nation's defense. Thank you for the opportunity to discuss the DPA with you today. We look forward to working with you to ensure a timely reauthorization of the DPA.