

July 1997

U.S. EXPORT-IMPORT BANK

Process in Place to Ensure Compliance With Dual-Use Export Requirements



**National Security and
International Affairs Division**

B-277356

July 17, 1997

Congressional Committees

Since October 31, 1994, the Export-Import Bank of the United States (Eximbank) has had statutory authority to finance exports of defense articles and services, provided that it determines that these items are nonlethal and for primarily civilian use. These exports, referred to by the Eximbank as "dual-use" exports, include such items as air traffic control systems that have military applications but will be primarily used for civilian purposes.

The Eximbank is authorized to use up to 10 percent of its total annual export financing authority to support the sale of dual-use exports. For fiscal year 1997, the Eximbank projects that this 10-percent cap on dual-use financing will amount to about \$1.6 billion.

The 1994 legislation (P.L. 103-428) that authorizes Eximbank financing of dual-use exports also directs our office to report to the Congress not later than September 1, 1997, on the end uses of dual-use exports financed by the Eximbank. This report responds to our statutory mandate and specifically discusses the results of our efforts to

- determine the nature and extent of the Eximbank's financing of dual-use exports,
- identify the actions the Eximbank has taken to help ensure that the dual-use exports it finances are nonlethal and will be primarily used for civilian purposes, and
- assess whether the actions provide a sound basis for determining that the dual-use exports it finances are nonlethal and will be primarily used for civilian purposes.

Background

The Eximbank supplements and facilitates private sector financing of U.S. exports of articles and services through its loan, loan guarantee, export credit insurance, working capital guarantee, and project financing

programs.¹ The Eximbank projects that, under these programs, its total export financing commitments for fiscal year 1997 will reach over \$16.5 billion.

With limited exceptions, the Eximbank is prohibited by law from financing the sale of defense articles and services. Under these exceptions, the Eximbank may provide financing to export (1) items on the U.S. munitions list that will be used for primarily drug interdiction purposes and whose sale the President determines to be in the national interest and (2) nonlethal defense items to be primarily used for civilian purposes, that is, dual-use items.

Results in Brief

The Eximbank's support for dual-use exports has increased during the last 3 fiscal years but has remained well under the annual 10-percent cap established by law. As of June 1997, the Eximbank had made commitments totaling \$226.1 million in loans and loan guarantees to support 10 dual-use exports to four countries. However, only one of the dual-use exports—involving aircraft parts and services to Indonesia—has actually been delivered overseas. Also, according to the Eximbank, 1 of the 10 exports will be used by a civil aviation authority; the other nine exports will be used by military organizations for primarily civilian purposes.

The Eximbank has established a process to help ensure that it can determine whether the dual-use exports it supports are nonlethal and primarily used for civilian purposes as required by law. For example, this process calls for the Eximbank to (1) review and approve applications for financing dual-use exports; (2) monitor the actual end use of these exports overseas; (3) obtain the views of other federal entities, such as the Departments of State, Treasury, and Commerce, for the purpose of approving the financing of dual-use exports and monitoring their end use; and (4) take appropriate corrective actions if the Eximbank discovers that the dual-use exports have been misused. The Eximbank is using electronic data bases to assist in tracking information on dual-use exports for monitoring purposes.

¹Loans provide direct financing to foreign buyers of U.S. exports. Loan guarantees provide repayment protection to lenders for loans made to foreign buyers of U.S. exports. Export credit insurance provides repayment protection to lenders and exporters for transactions involving U.S. exports sold to foreign buyers. Working capital guarantees provide repayment protection to lenders that provide working capital to U.S. businesses for the production of exports. Based on the revenues that major overseas capital projects are expected to generate, project financing provides loans, loan guarantees, or both, to finance these projects.

Our review indicated that the Eximbank process aimed at financing and monitoring dual-use exports, as currently implemented, should provide a sound basis for determining whether these exports are nonlethal and primarily used for civilian purposes. In the spring of 1997, for the one dual-use export that has taken place, Eximbank officials, assisted by other U.S. government officials, were able to verify that it was being primarily used for civilian purposes. Also, the State Department, in response to our request, obtained information from its pertinent missions overseas confirming that the other nine dual-use exports financed by the Eximbank were nonlethal and intended for primarily civilian use.

Nature and Extent of Eximbank Financing for Dual-Use Exports

The Eximbank has used only loans and loan guarantees to finance dual-use exports. According to Eximbank officials involved in reviewing, approving, and monitoring dual-use exports, the Eximbank could eventually use other financing programs, such as the working capital guarantee program, to finance these exports.

The value of the loans and loan guarantees that the Eximbank has provided to support exports of dual-use items has increased since fiscal year 1995 but has remained well under the value of the annual dual-use financing commitment cap. As shown in table 1, the Eximbank's dual-use export commitments have grown from \$15.4 million in fiscal year 1995 to \$108.3 million in fiscal year 1997, as of June 1997. Despite this growth, table 1 also indicates that this support has represented less than 1 percent of the total commitments for those fiscal years.

Table 1: The Eximbank's Total Export Financing Commitments and Dual-Use Financing Commitments, Fiscal Years 1995-97

Dollars in millions

Fiscal year	Total export financing commitments	Amount allowed under dual-use financing commitment cap	Dual-use financing commitments	Dual-use financing commitments as a percent of total export financing commitments
1995	\$11,864.9	\$1,186.5	\$15.4	0.1
1996	11,516.9	1,151.7	102.4	0.9
1997	16,521.7 ^a	1,652.2	108.3 ^b	0.7

^aProjected.

^bAs of June 1997.

Source: Eximbank.

Table 2 shows that the Eximbank has committed to support, through loans and loan guarantees, 10 dual-use exports to four countries during the last 3 fiscal years. This financing has amounted to \$226.1 million. Of this financing, Romania received \$79.5 million, Venezuela obtained \$74.3 million, Indonesia secured \$38.3 million, and Brazil got \$34.0 million. Two of the dual-use exports are intended for civil air traffic control, although one of them will be operated by a military organization. The other eight dual-use exports are intended for territorial development, which includes activities such as building schools, roads, and health facilities, and supporting humanitarian and disaster relief efforts. The Eximbank has determined that, although this territorial development is conducted by military organizations, it is still a civilian activity. (See app. I for further details on individual dual-use loans and loan guarantees.)

Table 2: Type of Eximbank Dual-Use Financing Commitments, Fiscal Years 1995-97

Dollars in millions

Fiscal year	Recipient country	Type of Eximbank financing/ description of export	Amount of Eximbank financing	End user	Intended end use
1995	Indonesia	Loan/aircraft parts and services	\$15.4	Indonesian Air Force	Territorial development
1996	Romania	Guarantee/air traffic control system	79.5	Romanian civil aviation authority	Civil air traffic control
	Indonesia	Loan/helicopters	22.9	Indonesian Army	Territorial development
1997	Venezuela	Guarantee/radio systems	8.8	Venezuelan Army	Territorial development
	Venezuela	Guarantee/radio systems	3.4	Venezuelan Air Force	Civil air traffic control
	Brazil	Loan/aircraft components	34.0	Brazilian Air Force	Territorial development
	Venezuela	Guarantee/trucks	25.5	Venezuelan Army	Territorial development
	Venezuela	Guarantee/trucks	14.1	Venezuelan Army	Territorial development
	Venezuela	Guarantee/aircraft parts	10.1	Venezuelan Army	Territorial development
	Venezuela	Guarantee/motor vehicles	12.4	Venezuelan Army	Territorial development

Source: Eximbank.

As of June 1997, only the first of the 10 dual-use exports financed by the Eximbank had actually been shipped—the 1995 export of aircraft parts and services to Indonesia.

Eximbank Process for Financing and Monitoring Dual-Use Exports

The Eximbank has established a process for financing and monitoring dual-use exports to help ensure that these exports are nonlethal and primarily used for civilian purposes as required by law. This process involves reviewing and approving applications for financing these exports and monitoring the actual end use of the exports through reporting, certifications, and site visits.

Applications for Financial Support Reviewed and Approved

The review and approval of each application for supporting dual-use exports is to start with an examination of the nature of the exports, their intended end use, and their end users. The Eximbank's Engineering and Environment Division has overall responsibility for determining the eligibility for financing of dual-use exports. In this division, applications for financing these exports are to be reviewed by engineers having expertise in the particular sector—electronics, air transportation, etc.—under which the applications fall. If external assistance is needed, Eximbank staff may obtain additional information on particular transactions from other U.S. agencies, such as the Departments of State, Treasury, and Commerce. For example, before approving the loans to finance dual-use exports to Indonesia, the Eximbank obtained assessments from the Department of State as to the intended use of these exports.

According to the Vice President of the Eximbank's Engineering and Environment Division, in determining that dual-use exports will be primarily used for civilian purposes, Eximbank engineers are to recommend approval of financing for dual-use exports only when their investigations reveal unambiguously that the intended civilian use of the exports is significantly greater than the intended military use.

The Eximbank's Board of Directors is to assess and approve applications for financing dual-use exports based on recommendations for action and technical evaluations prepared by Eximbank staff.² In addition, as required by the dual-use legislation, the Eximbank must notify the Congress of

²The Board of Directors, which manages and sets policy for the Eximbank, is composed of five full-time members appointed for 4-year terms by the President of the United States with the advice and consent of the U.S. Senate. In addition, the Secretary of Commerce and the U.S. Trade Representative serve as ex officio, nonvoting members.

dual-use transactions at least 15 calendar days before approving them. Also, the Eximbank seeks the advice of the National Advisory Council on International Monetary and Financial Policies (NAC) on dual-use transactions before deciding to support them.³ According to the Vice President of the Engineering and Environment Division and the Eximbank liaison at the Department of State, NAC members regularly receive copies of the memorandums to the Board of Directors that contain the recommendation for action on a dual-use export before the board makes a decision. The Eximbank liaison noted that he normally sends copies of the memorandums to the pertinent country desks for review and makes certain that the appropriate U.S. missions receive a copy for comment.

As part of the review and approval process, the Eximbank is to incorporate in financing agreements requirements that must be satisfied by the buyers before and after loans or loan guarantees are ready for disbursement. For example, the financing agreements pertaining to the first three dual-use exports financed by the Eximbank contain provisions that allow it, among other things, to obtain end-use certificates from the buyers before disbursement and to secure access to exports abroad for monitoring purposes.

End Use of Dual-Use Exports Monitored, and Penalties for Misuse Outlined

Until the loans or loan guarantees are repaid, the Eximbank process requires that the buyers provide periodic reports and certificates about the actual usage of the dual-use exports. Also, under this process, the Eximbank retains the right to send its technical staff overseas to monitor the actual end use of dual-use exports. The Eximbank's Engineering and Environment Division has overall responsibility for monitoring the actual end use of these exports. If further external support is needed in monitoring these exports, this division may request it from other U.S. government agencies, such as the Department of State. This division recently issued a guideline on work progress reports and technical operating reports to help monitor dual-use exports.

If the Eximbank discovers that the intended use of the dual-use exports has been misrepresented, it can take appropriate corrective actions. These actions can include accelerating repayment of a transaction, taking administrative steps or imposing punitive measures according to the

³NAC is composed of the following members: the Secretary of the Treasury, who is the Chairman of the Council; the Assistant to the President for Economic Affairs, who is the Deputy Chairman of the Council; the Secretary of State; the U.S. Trade Representative; the Secretary of Commerce; the Chairman of the Board of Governors of the Federal Reserve System; the Director of the International Development Cooperation Agency; and the President of the Eximbank.

nature of the transaction, and/or suspending the buyer from access to future Eximbank financing.

Electronic Data Base Systems Used for Monitoring Dual-Use Exports

To track information on dual-use transactions for monitoring purposes, the Eximbank has enhanced its Application Processing System (APS). The Eximbank uses this system to record information on all of the export-related transactions, such as dual-use export transactions. The Eximbank recently added a data field in the APS to distinguish its dual-use export transactions from other transactions contained in the system. As a result, the Eximbank can now more readily identify the dual-use export transactions and can regularly produce reports on these transactions for monitoring purposes.

The Engineering and Environment Division is also developing a data base system to process progress and operating reports required by many Eximbank transactions, especially dual-use transactions. This system is expected to collect data such as the type of transaction involved, the reporting requirements, the scheduled dates on which the progress and operating reports are due, and the actual dates on which they are received. By allowing easy processing of progress and operating reports, this system is intended to play a major role in tracking information on dual-use exports and in monitoring the civilian end use of these exports. According to the Eximbank's Vice President of the Engineering and Environment Division, the latter system is scheduled to be fully operational by the end of fiscal year 1997.

Eximbank Process Provides a Sound Basis for Determining Whether Dual-Use Exports Will Be Primarily Used for Civilian Purposes

The Eximbank's process to manage dual-use exports—as currently implemented—should provide a sound basis for determining whether these exports are nonlethal and will be primarily used for civilian purposes. The Eximbank and the State Department recently verified the civilian end use of the 1995 dual-use export of aircraft parts and services delivered to Indonesia.

The Eximbank's process is designed to help the Eximbank (1) secure critical information—such as the nature of the dual-use exports and their intended end use—for the purpose of reviewing and approving applications for financing these exports; (2) obtain access to the dual-use exports overseas to monitor their actual end use; and (3) have a legal basis, based on provisions contained in financial agreements, to take appropriate corrective actions regarding the financing involved if the

Eximbank discovers that the dual-use exports are not being used as intended. This process also allows the Eximbank to obtain assistance and information from other U.S. federal entities, such as NAC and the Department of State, for reviewing and approving financial applications on dual-use exports and for monitoring the actual end use of these exports.

In March 1997, Eximbank officials used this process to obtain a civilian end-use certificate from the user and to verify that the use of the 1995 dual-use export of aircraft parts and services to Indonesia had actually been for primarily civilian purposes. As part of this verification, Eximbank officials, accompanied by Department of State and Department of Defense officials, were able to determine that this export had been used, as planned, to repair seven aircraft that were being or would be used for territorial development. In this case, territorial development included activities such as humanitarian aid efforts and relief, air transport of food, and transportation of civilians to the country's outer islands.

These officials ascertained that (1) four of the aircraft were stationed in Jakarta and three in Malang, (2) two of the aircraft stationed in Jakarta were certified to fly and the remaining two were undergoing flight certification testing, (3) flight logs for these two certified aircraft were available for review in Jakarta, and (4) flight logs for the three aircraft stationed in Malang were not available for review in Jakarta. The officials conducted a random review of the flight logs for the two certified aircraft stationed in Jakarta and obtained a copy of their flight logs for November 1996. According to Eximbank officials responsible for monitoring this dual-use export, the Eximbank plans to secure additional end-use information on all of the certified aircraft by the next reporting milestone in the spring of 1998.

Also, in the spring of 1997, in response to our request for information on the end use of the dual-use exports financed by the Eximbank, the State Department, with information provided by the U.S. embassy in Indonesia, reported that it had no information indicating that this export had been misused.

In response to our request, the State Department, with information provided by the U.S. embassies in Indonesia, Romania, Venezuela, and Brazil, was able to confirm that the other nine dual-use exports financed by the Eximbank were intended for primarily civilian purposes.

Scope and Methodology

The legislation giving the Eximbank the authority to finance exports of dual-use items required us to report to the Congress on the end uses of the dual-use items financed during fiscal year 1995. In discussions with representatives of congressional committees, we agreed not only to report on the dual-use export financed in 1995 but also to provide information on the other nine exports financed during fiscal years 1996 and 1997. Also, we agreed to rely on information collected by the Eximbank and the State Department on the actual end use of the 1995 dual-use export to Indonesia.

To determine the nature and extent of the Eximbank financing of dual-use items, we reviewed pertinent Eximbank documents and interviewed cognizant Eximbank officials, including the Chief Financial Officer, the Vice President of the Engineering and Environment Division, and the engineers having responsibility for reviewing dual-use export applications and monitoring the end use of these exports. To confirm that the Eximbank had identified all of the dual-use items for inclusion in our review, we performed a comprehensive file review of fiscal year 1995-97 transactions having potential military implications. We identified these transactions in the Eximbank's export data base system by using the standard industrial classifications (SIC) employed by the Eximbank and the U.S. Bureau of Labor Statistics to identify articles and services having military implications. The latter SICs allowed us to determine whether the SICs the Eximbank used in its export data base had missed any transactions having military implications. In assessing whether the Eximbank had adequately applied its dual-use exports criteria, we reviewed a number of its transactions having military implications to learn how the Eximbank had distinguished its dual-use exports from its other exports.

To identify the actions taken by the Eximbank for ensuring that the dual-use exports are primarily used for civilian purposes, we reviewed pertinent government documents and interviewed public officials, including the State Department's Eximbank liaison and, in addition to Eximbank officials previously mentioned, the Eximbank's Associate General Counsel, the attorneys responsible for the items financed, the Vice President of the Credit Administration, and the contract officers responsible for the items financed.

To assess whether the Eximbank actions previously described provide a reasonable assurance that it can determine whether its dual-use exports are nonlethal and will be primarily used for civilian purposes, we reviewed

pertinent government documents and interviewed public officials, including the State Department's official and the Eximbank officials previously mentioned. Also, we asked the State Department to highlight—after querying cognizant U.S. embassies—any concerns it might have regarding the intended end uses of the 10 dual-use exports financed by Eximbank.

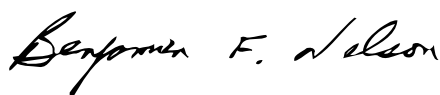
We conducted our work from September 1996 to June 1997 in accordance with generally accepted government auditing standards.

Agency Comments

We requested comments on a draft of this report from the Chairman and President of the Eximbank, or his designees. On July 8, 1997, we obtained oral comments from Eximbank officials, including the Executive Vice President and the Associate General Counsel. These officials generally agreed with the information presented in the draft report. Also, they provided some technical comments, which we incorporated in the report where appropriate.

We are sending copies of this report to other appropriate congressional committees, the Chairman and President of the Eximbank, and the Secretaries of State and Defense. We will also make copies available to others upon request.

This review was done under the direction of Jess T. Ford, Associate Director. If you or your staff have any questions concerning this report, please contact Mr. Ford at (202) 512-4268. Major contributors to this report are listed in appendix II.



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Abbreviations

APS	Application Processing System
NAC	National Advisory Council on International Monetary and Financial Policies
SIC	standard industrial classification

U.S. Export-Import Bank-Financed Dual-Use Loans and Loan Guarantees

Since fiscal year 1995, the Export-Import Bank of the United States (Eximbank) has provided 10 loans and loan guarantees to finance exports of nonlethal defense articles and services primarily intended for civilian use—referred to by the Eximbank as “dual-use” exports. The following provides a brief description of these loans and loan guarantees.

Financial Support for Dual-Use Exports in Fiscal Year 1995

On September 26, 1995, the Eximbank approved a \$15.4-million, 10-year loan to finance a dual-use export of aircraft parts and overhaul services to Indonesia (Case No. AP 68716). This loan would allow the Indonesian government to refit, refurbish, and overhaul five C-130 and two L-100 aircraft that the Indonesian Air Force intended to use for primarily civilian purposes, such as humanitarian aid efforts and relief; air transport of food, water, and medical supplies; search and rescue missions; transportation of civilians to the country’s outer islands; maritime and pollution surveillance; weather monitoring; and air traffic control. Derco Industries, Inc., Milwaukee, Wisconsin; National Airmotive Corp., Oakland, California; and Pacific Propeller, Inc., Kent, Washington, would provide the aircraft parts and services for this dual-use export.

Financial Support for Dual-Use Exports in Fiscal Year 1996

On October 26, 1995, the Eximbank approved a \$79.5-million, 13-year loan guarantee to finance a dual-use export of air traffic control systems to Romania (Case No. AP 68527). This loan guarantee would allow the Romanian government to procure five FPS-117 radar systems for modernizing the air traffic control system operated and maintained by the civil aviation authority. Lockheed Martin Corporation, Liverpool, New York, would provide the radar systems for this dual-use export.

On December 5, 1995, the Eximbank approved a \$22.9-million, 5-year loan to finance a dual-use export of refurbished Bell helicopters to Indonesia (Case No. AP 69128). This loan would allow the Indonesian government to acquire 21 refurbished Bell 205-A1 helicopters, including spare parts, ground support equipment, and support services, for use by the Indonesian Army for primarily civilian purposes. The army would use the helicopters to promote the Indonesian government’s territorial development mission, which includes building schools, roads, churches, and health facilities, and supporting humanitarian and disaster relief efforts. Southwest Florida Aviation, Punta Gorda, Florida, would provide the refurbished helicopters for this dual-use export.

Financial Support for Dual-Use Exports in Fiscal Year 1997

On February 20, 1997, the Eximbank approved an \$8.8-million, 7-year loan guarantee to finance a dual-use export of high frequency radio systems to Venezuela (Case No. AP 69097). This loan guarantee would allow the Venezuelan government to procure a communications network of high frequency radio systems for use by the Civil Action Communications Division of the Venezuelan Army for primarily civilian purposes in remote areas of the country. The army would use the equipment to provide, for example, disaster relief, environmental protection, medical assistance, and border control in frontier regions, especially along the border with Brazil. Harris Corporation, Rochester, New York, would provide the radio systems for this dual-use export.

On February 20, 1997, the Eximbank approved a \$3.4-million, 6-year loan guarantee to finance a dual-use export of radio systems to Venezuela (Case No. AP 70876). This loan guarantee would allow the Venezuelan government to upgrade existing radio systems used by the air force in the country's air traffic control system. This export, as part of the modernization of the Venezuelan air traffic control system, would permit the air force to track and control unauthorized flights and increase the safety of civilian air traffic. Comtech Systems, Inc., St. Cloud, Florida, would provide the radio systems for this dual-use export.

On March 4, 1997, the Eximbank approved a \$34-million loan to finance a dual-use export of aircraft components to Brazil (Case No. AP 67303). This action amended a loan initially approved on September 30, 1994, to support an infrastructure project for the development and protection of the Amazon region in Brazil. This loan would allow the Brazilian government to procure components for five Embraer 145 aircraft for use by the air force for primarily civilian purposes, such as communication relays for civilian agencies, support for law enforcement and smuggling control activities by federal and local police, and environmental monitoring activities. Raytheon Company, Lexington, Massachusetts, would provide the aircraft components for this dual-use export.

On March 4, 1997, the Eximbank approved a \$25.5-million, 7-year loan guarantee to finance a dual-use export of trucks to Venezuela (Case No. AP 70223A). This loan guarantee would allow the Venezuelan government to procure 450 remanufactured M-35, 2-1/2 ton trucks for use by the Venezuelan Army for primarily civilian purposes. The army would use the trucks for transporting army personnel in situations involving disaster relief, medical assistance, environmental protection, border

control, and other civilian missions. Commercial Military Systems Co., Augusta, Georgia, would provide the trucks for this dual-use export.

On March 20, 1997, the Eximbank approved a \$14.1-million, 5-year loan guarantee to finance a dual-use export of trucks to Venezuela (Case No. AP 69893). This loan guarantee would allow the Venezuelan government to procure trucks and other vehicles, including jeeps, tractors, and construction equipment for use by the Division of Construction and Maintenance of the Engineering Department of the army for primarily civilian purposes. These include the construction and maintenance of roadways, buildings, schools, and construction improvements for the population living in the frontier regions of the country. ATN Industries Inc., Miami, Florida, would provide the trucks for this dual-use export.

On March 20, 1997, the Eximbank approved a \$10.1-million, 6-year loan guarantee to finance a dual-use export of aircraft and helicopter spare parts to Venezuela (Case No. AP 70049). This loan guarantee would allow the Venezuelan government to refurbish a number of small aircraft, such as Beechcraft, Cessna, Arava, Augusta, Bell 4125P, UH-1H, and Sikorsky, for use by the army for primarily civilian purposes. The army would use the aircraft to provide civilian support in activities related to disaster relief, medical assistance, border control, water contamination, and environmental protection. Horizon Aircraft Sales, Inc., Miami, Florida, would provide the aircraft and helicopter spare parts for this dual-use export.

On March 20, 1997, the Eximbank approved a \$12.4-million, 6-year loan guarantee to finance a dual-use export of motor vehicles to Venezuela (Case No. AP 71127). This loan guarantee would allow the Venezuelan government to procure 720 vehicles—150 cars, 170 trucks, and 400 utility vehicles—for use by the army for primarily civilian purposes. The army would use these vehicles to support civilian and humanitarian activities, such as medical aid, natural disaster relief, protection of the environment, border patrol, and antinarcotics efforts. ATN Industries Inc., Miami, Florida, would provide the vehicles for this dual-use export.

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