

## **End-Use Monitoring of Defense Articles and Defense Services Commercial Exports FY04**

This report describes the actions the Department of State took in the past fiscal year under Section 40A of the Arms Export Control Act (AECA) to implement end-use monitoring of the commercial export of defense articles, services, and related technical data subject to licensing under Section 38 of the AECA. The Directorate of Defense Trade Controls, in the Bureau of Political-Military Affairs (PM/DDTC), Department of State, is responsible for administering the International Traffic in Arms Regulations (ITAR) that implement the AECA. DDTC's functions include registration of manufacturers, brokers, and exporters, licensing of commercial defense trade, overseeing compliance with U.S. export regulations, supporting U.S. law enforcement agencies in criminal investigations and prosecutions of AECA violations, as well as the end-use monitoring of licensed transactions. End-use monitoring entails pre-license or post-shipment checks on any party or other aspect of a defense trade transaction in order to verify its bona fides.

DDTC is currently authorized a full-time complement of 71 State Department personnel, which is supplemented by eight military officers and about 40 contract personnel working on defense trade licensing and end-use monitoring efforts. DDTC's operational budget for FY 2004 was approximately \$13.4 million.

### Overseas Monitoring: The Blue Lantern Program

Initiated in September 1990 as the first systematic end-use check program, the Blue Lantern program has strengthened export controls and has proven to be a useful instrument in: 1) deterring diversions, 2) aiding the disruption of illicit supply networks used by rogue governments and international criminal organizations, and 3) helping the Department make informed licensing decisions and ensuring compliance with the AECA and the ITAR. End-use checks performed under the Blue Lantern program have significantly encouraged compliance with legal and regulatory requirements and have proven particularly effective in addressing the growing problem of gray arms trade (the use of fraudulent export documentation to acquire defense articles through legitimate channels for end-users inimical to U.S. interests). U.S. embassy personnel, or, in some instances, DDTC personnel, conduct Blue Lantern end-use checks abroad to verify the specific end-use and end-user of commercial defense exports and transfers controlled under the AECA.

Although most commercial defense trade is legitimate, a small percentage of cases can fall prey to gray arms manipulations. The goal of the Blue Lantern program is to prevent gray arms networks from misleading our export control process to obtain military items and technologies. The roughly 500 Blue Lantern checks conducted each year are the result of a targeted selection process to efficiently identify transactions that are most vulnerable to this type of diversion or misuse. License applications and approvals undergo review by Licensing and Compliance officers, who compare the details of the case with specified, time-tested criteria to determine a transaction's suitability for a Blue Lantern check. DDTC reviews about 60,000 transactions annually, and the knowledge and trend analysis derived from the 500 checks is used by DDTC to better assess the national security concerns associated with the export of specific defense articles controlled by the U.S. Munitions List.<sup>1</sup>

### Results of End-Use Checks in FY 2004

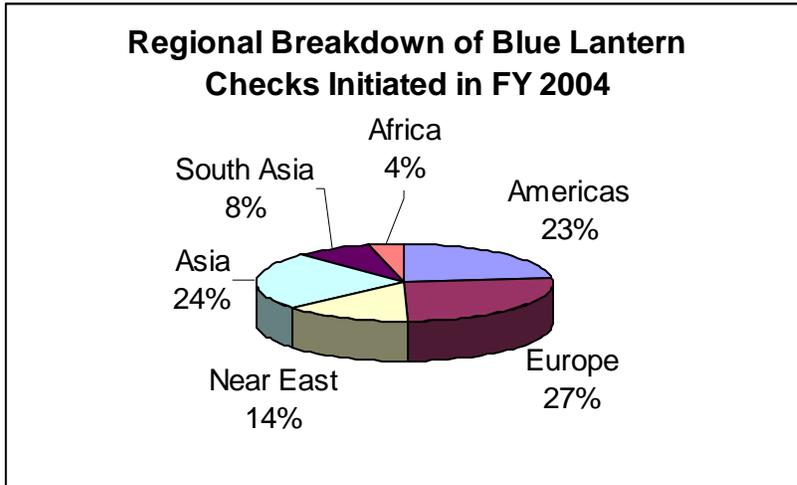
In FY 2004, DDTC initiated 530 checks, a record number in the history of the program. Blue Lantern checks performed in FY 2004 resulted in 93 unfavorable cases, which is the highest number of unfavorable

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<sup>1</sup> Due to the targeted approach of the Blue Lantern Program, caution must be used when using this data for statistical purposes.

checks in the history of the Blue Lantern program (representing nearly 18% of total checks conducted). A regional breakdown of the 530 checks performed in 2004 follows in Table 1. The regional breakdown in FY 2004 is comparable to FY 2003, although there was a slight increase in the percentage of Blue Lantern checks in Africa and a more substantial decrease in the percentage in the Americas.

Table 1:



In response to a January 2004 report by the Government Accountability Office (GAO) on “Improvements Needed to Better Control Technology Exports for Cruise Missiles and Unmanned Aerial Vehicles,” DDTC increased substantially the number of Blue Lantern post-shipment checks on unmanned aerial vehicle (UAV) components for private and government end users. During FY 2004, DDTC initiated 18 checks on UAV components. Of these 18 checks, 10 are either underway or completed, and 2 have already come back with unfavorable results. The first unfavorable case was for UAV spare parts that were reportedly destined for a European military end-user. However, the Blue Lantern revealed that the spare parts were for testing by a private company. In the second case, the ostensible end-user in Africa could not be located. Both cases have been referred to DDTC’s Enforcement Division for further action. Pursuant to the GAO Report, DDTC continues to target UAV licenses for Blue Lantern end-use checks.

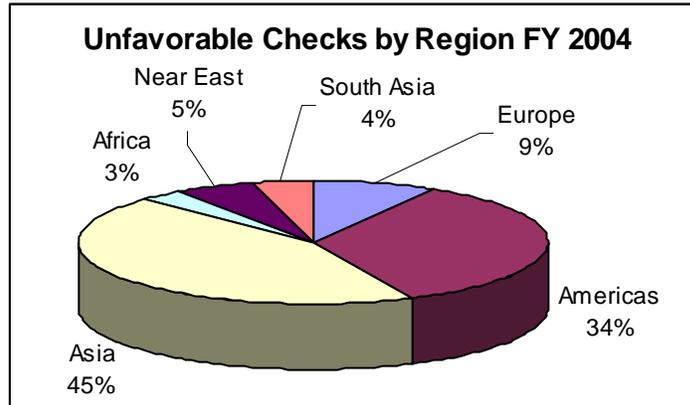
Analysis of Unfavorable Checks by Commodity:

Of commodities involved in unfavorable determinations, the most prevalent remains firearms and ammunition, which together represented 18% (17/93) of unfavorable cases; this, however, represents a marked decrease from FY03 when firearms and ammunition cases constituted a full 49% (37/76) of unfavorable Blue Lanterns. The percentage of unfavorable checks involving aircraft spare parts at risk of diversion to prohibited countries such as China and Iran (who actively seek spare parts to circumvent U.S. embargoes and to increase the operational readiness of military aircraft in their inventories), jumped from 24% (18/76) in 2003 to 35% (33/93) in 2004. The increase in the percentage of unfavorable checks involving aircraft spare parts is also noteworthy because the number of checks conducted on aircraft spare parts remained the same as in 2003. The next category, electronics and communications equipment, captured 18% (17/93) of the unfavorable cases. The remaining unfavorable checks involved commodities such as missile spare parts, military training equipment, and night vision equipment.

Analysis of Unfavorable Checks by Region:

In FY 2004, countries in Asia comprised 45% percent of the unfavorable checks. This high proportion may be attributed to the greater number of checks overall conducted in this region in FY 2004. Europe, traditionally quite high in the number of unfavorable cases, decreased to 9% from 18% in 2003.

Table 2:



Generally, the unfavorable cases in the Western Hemisphere region involved commodities such as firearms, ammunition, and explosives. Asia's unfavorable cases revealed aircraft and helicopter spare parts, as well as electronics and communications equipment, to be in high demand.

Reasons for Unfavorable Checks in FY 2004:

In 38% of the unfavorable cases closed in 2004, the purported end-user did not order the items that were the subject of the inquiry. In 12% of the unfavorable cases, derogatory information was found on one or more of the parties involved. Misuse or unauthorized transfers were found in nearly 9% of the unfavorable cases. In 8% of unfavorable cases, the foreign end-user could not adequately justify the purchase of what was established by DDTC to be an excessive quantity of items requested. Also in 11% of the unfavorable cases, the foreign company was not found or company officials did not cooperate with the inquiry. Unfavorable Blue Lanterns are routinely referred to DDTC's Enforcement Division (END) for coordination with the Department of Justice for possible criminal action or civil action within the Department.

The following examples illustrate the effectiveness of the Blue Lantern Program in FY 2004:

- A pre-license check on the export of gyroscopes to a Southeast Asian country for use in CASA 212 aircraft was returned with unfavorable results when the end-user, as well as the foreign consignee, denied ever placing the order. As a result, the licenses were not approved and future licenses involving those entities will be subject to additional scrutiny.
- A pre-license check on several requests to export F-5 aircraft parts to a Southeast Asian country via a known illicit trafficker in the Middle East revealed that the end-user had no contract with the foreign consignee. DDTC denied the licenses.
- A post-license check for the export of C-130 aircraft parts to a government in the Middle East via a Southeast Asian foreign intermediate consignee found that the government did not have either a

contract or a firm order with the company. DDTC updated information on the consignee in its “Watchlist” of entities suspected of illicit activities and/or requiring special scrutiny.

- A pre-license check for the export of gas masks to a South American country revealed that the end-user did not exist. DDTC denied the license and added the end-user to its Watchlist.
- A pre-license check for CH-47 helicopter spare parts to a European country found that the end-user never placed an order for the parts and had no relationship with the foreign consignee. Pending further review of this case by DDTC’s Licensing Division and END, DDTC added the foreign consignee to its Watchlist.
- A pre-license check involving pistols to be exported to a Central American country revealed that the end-user had been set up as a front company for another firearms retailer that was under investigation by the local government for export violations. DDTC denied the license and added both companies to its Watchlist.

#### Compliance/Enforcement: State-ICE Cooperation

Cooperation between the State Department and the Immigration and Customs Enforcement (ICE) bureau of the Department of Homeland Security (DHS) also plays a vital role in tackling and inhibiting gray arms activity. (ICE has authority to investigate criminal violations of the AECA.) In FY04, cooperative programs between State and ICE facilitated more than 923 commercial arms seizures at U.S. ports of exit totaling almost \$136 million, a significant increase from the \$106 million reported in FY 2003. ICE has two officers assigned to the State Department to coordinate Department support for criminal investigations and coordinate documents for prosecutions of the AECA.

Effective enforcement and compliance with U.S. regulations could not be possible without close cooperation between DHS – both ICE and its Customs and Border Protection (CBP) bureau – and the Directorate of Defense Trade Controls. The goal of this cooperative effort is the verification of licensed exports and the compliance of exporters. As part of this effort, DDTC electronically provides licensing data that allows for accurate, real-time monitoring by DHS officials of commercial arms moving in and out of the United States. Through ICE’s Operation Exodus, DDTC also provides authoritative opinions, rulings, and advice on a daily basis to ICE concerning licensing and other regulatory requirements.