



Transfer of Defense Articles: Direct Commercial Sales (DCS)

United States firms received licenses to export more than \$136 billion of defense articles and services in FY 2018 directly to eligible foreign entities, be they governments, corporations, or individuals. Such transactions are conducted as Direct Commercial Sales (DCS), for which the U.S. government (USG) issues export licenses to U.S. firms through a process that includes a review for adherence to U.S. law and policy. DCS is distinct from Foreign Military Sales (FMS), in which the U.S. government procures U.S. defense articles as an intermediary for foreign partners. (See CRS In Focus IF11437, *Transfer of Defense Articles: Foreign Military Sales (FMS)*, by Nathan J. Lucas and Michael J. Vassalotti.

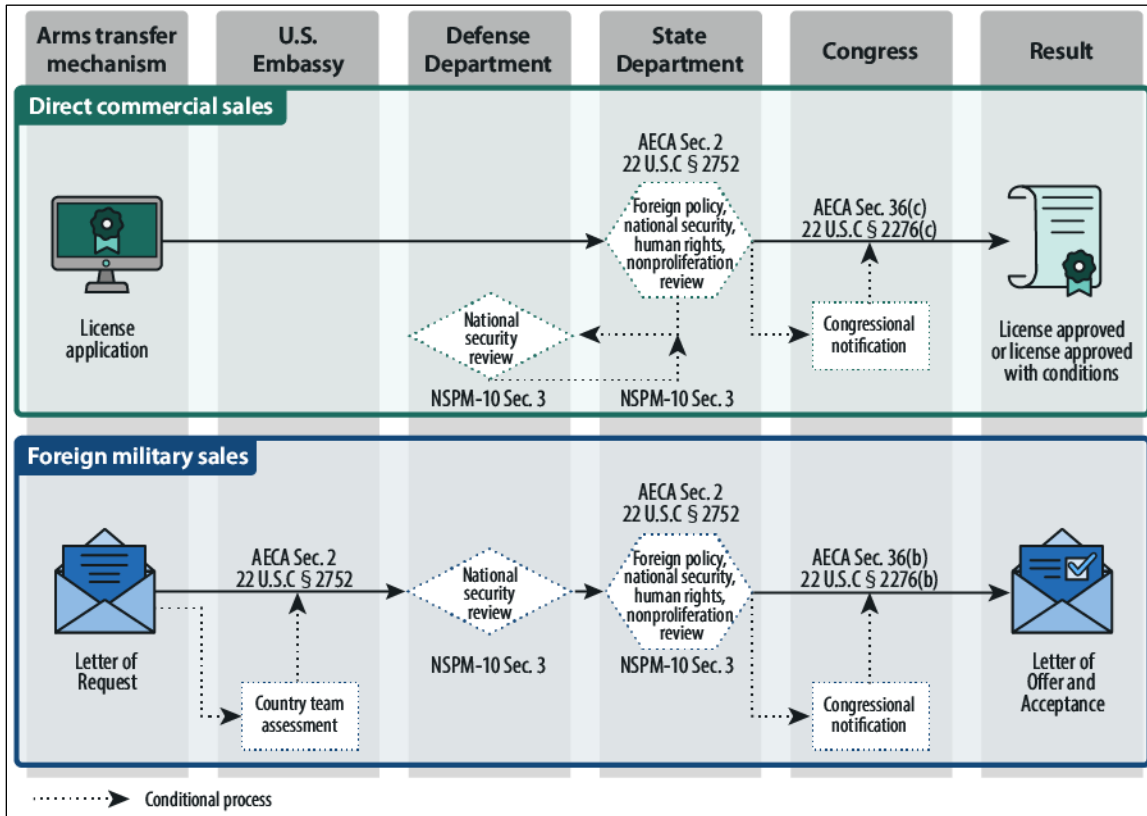
Congress authorized DCS licensing in the Arms Export Control Act (AECA) of 1976 (22 U.S.C. §2751 et. seq.) and provides active oversight of the program through annual Department of State and Foreign Operations Appropriations Acts and the National Defense Authorization Acts. It also exercises oversight in the response to executive branch notifications of foreign arms sales. Through these

mechanisms, Congress may limit or prohibit DCS to certain countries, or encourage the use of DCS in other cases.

Administration policy is found in National Security Presidential Memorandum 10 (NSPM-10) on “U.S. Conventional Arms Transfer Policy,” published in 2018. Federal regulations, 22 C.F.R. 120-130, contain the International Traffic in Arms Regulations (ITAR) and the U.S. Munitions List (USML), both of which regulate the items restricted under the AECA.

Pursuant to the AECA, section 38, (22 U.S.C. §2778), all persons (other than USG personnel performing official duties) engaging in manufacturing, exporting, or importing defense articles and services must register with the U.S. Department of State under the ITAR. The law also requires the President to review the USML and to notify the House Foreign Affairs Committee, the Senate Foreign Relations Committee, and the Senate Banking Committee if any items no longer warrant export controls.

Figure 1. Direct Commercial Sales (DCS) Licensing Process In Comparison With Foreign Military Sales (FMS)



Source: GAO, “Conventional Arms Transfer Policy: Agency Processes for Reviewing Direct Commercial Sales and Foreign Military Align With Policy Criteria,” GAO-19-673R, September 9, 2019. Annotated by CRS.

In DCS, registered U.S. firms sell defense articles directly to authorized foreign customers under licenses received from the State Department. As with FMS, where the USG acquires the articles for delivery to foreign customers, firms engaged in DCS must first obtain U.S. Department of State (DOS) approval. U.S. Department of Defense (DOD) review and congressional notification may also be required.

Similar USG Review Process to FMS

For a U.S. firm to export defense articles or services on the USML, it must first register with the State Department's Directorate of Defense Trade Controls (DDTC). While DCS originates between registered U.S. firms and foreign customers, an application for an export license goes through a review process similar to FMS (Figure 1). DOS and DOD have agency review processes that assess proposed DCS transfers for foreign policy, national security, human rights, and nonproliferation concerns.

A DCS transaction may originate between a U.S. firm and a foreign entity, may be initiated through a U.S. embassy overseas, or may arise between foreign diplomatic or defense personnel stationed in the U.S. DCS licenses and FMS cases differ in that in DCS, the USG does not participate in the sale or procure the defense articles or services.

Firms May Consult With USG Officials Before Applying for DCS Licenses

Prior to a firm's submission of a DCS license application, officials from DOS and DOD may work with a foreign entity to review the needs of the country and the type and intended use of defense articles to determine if a sale would be consistent with U.S. national security interests.

Pursuant to Title 22, United States Code, foreign arms sales are subject to the continuous supervision and general direction of the Secretary of State, to best serve U.S. foreign policy interests. Within DOS, the Bureau of Political-Military Affairs (PM) is the main administrator for arms transfers, including DCS. PM implements DCS through the Directorate of Defense Trade Controls (DDTC). PM manages DCS applications, submitting the proposed sale for internal and interagency review and consultation with Congress in order to receive approval to grant a license.

The Security Cooperation Office (SCO) chief (within the U.S. embassy) and other members of the country team normally meet with visiting U.S. defense industry representatives regarding their experiences in country. The SCO chief responds to follow-up inquiries from industry representatives regarding host country officials' reactions or subsequent marketing efforts by foreign competitors. The SCO chief and embassy staff observe host country officials' reactions to U.S. defense industry marketing efforts. He/she may pass these reactions to the U.S. industry representatives, but the SCO may not work on behalf of any single U.S. firm; the only preference can be for purchasers to "buy American." If the SCO chief believes that a firm's marketing efforts do not coincide with U.S. security interests or may damage U.S. relations with the country, he or she is to relay these concerns, along with a request for guidance, throughout the country team and to the

Combatant Command, Military Department, and the Defense Security Cooperation Agency (DSCA).

DOD may sell articles or services via FMS to a commercial firm or to the DCS purchaser in support of DCS but it needs a Letter of Request from the purchaser pursuant to an approved export license. FMS implementing agencies may not participate in FMS-commercial comparison. If the purchaser's national policy or specific circumstances require that FMS and commercial data be obtained for purchase, the purchaser submits a request for exception to DSCA via the SCO.

Firms Can Request a DCS Preference Generally, the USG supports arms sales to allies and partners for legitimate defense and is neutral as to use of FMS or DCS. Unless the foreign entity requests a purchase be made through FMS (with DOD as its agent), DOD tries to accommodate a U.S. defense firm's preference for DCS if articulated. DOD does not normally provide price quotes for comparison of FMS to DCS. If a party prefers that a sale be made commercially and when a company receives a request for proposal from a country, the company may request that DSCA issue a DCS preference for that particular sale. DCS preferences are valid for one year.

Congressional Notification Requirements for DCS

The AECA, Section 36(c) (22 U.S.C. §2776(c)), specifies reporting to Congress on the following:

- 30 calendar days before issuing an export license for major defense equipment valued at \$14 million or more, or defense articles or services valued at \$50 million or more.
- 15 calendar days before issuing an export license for NATO member states, NATO, Japan, Australia, South Korea, Israel, or New Zealand for sale, enhancement, or upgrading of major defense equipment valued at \$25 million or more, defense articles or services at \$100 million or more, or design and construction services of \$300 million or more.

Congress reviews formal notifications pursuant to procedures described in the AECA. See CRS Report RL31675, *Arms Sales: Congressional Review Process*, by Paul K. Kerr.

Firms Obtain Export Licenses

Firms must obtain export licenses for all defense articles and must follow the International Traffic in Arms Regulations. Licenses are valid for four years.

In some cases involving major weapons systems, comprehensive export authorizations under 22 CFR 126.14 allow exports and technical data transfer to certain nations without having to go through the licensing process. The F-35 Joint Strike Fighter program is an example.

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