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CONFLICTS ON EXPORT CONTROLS AND DEFENSE TRADE MATTERS

Terence Murphy & Douglas Forsythe***

It is a dispute with the United States that has been going on for at least a year. As a matter of fact, it pre-dates that. All of us involved in it had really thought we would have a deal; we would have a package that we could discuss. We are still not there. We are getting there. So I hope you will bear with me and allow a certain amount of caution in some of my remarks simply because we just do not yet have a deal. But I will try to take you as far along as I can.

For a bit of historical context, if I may; much of the Canadian-U.S. relationships on export controls arise out of the 1941 Hyde Park Agreement. That agreement arose out of a meeting between President Roosevelt and Prime Minister MacKenzie King which led through the war and then the post-war period to increasing integration of the defense industrial base in North America. Part of the regime seen through those treaties and defense arrangements and MOU's and exchanges of notes led to Canadian industry becoming integrated into the U.S. defense industry and vice versa. It allowed for us to adopt the common security approach to North America. It manifested itself in our defense relationship with NORAD,¹ and on the export control side, a fairly free movement of goods whereby a lot of U.S. defense items moved into Canada, and Canadian defense moved into the United States without export controls. This was of a great advantage, certainly, to our defense industries, and a great advantage to the American military in terms of procurement.

Things have changed in the world in terms of security. Security concerns have changed. The concerns have changed very much, certainly driven by American concerns, but we also share many of those concerns. One of the great problems with the ITARs is the distance between where we agree in principle, but somehow on the details, we just cannot seem to make it work.

The biggest change came in dealing with changes to the Canadian exemption, both in the commerce regime of controls and the State Department regime. There are Canadian exemptions. Some of this comes out

* Murphy bio.

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¹ North American Aerospace Defense Command.

of some changes to the ITARs driven by non-Canadian events, if you will. One of which was coming out of the Cox Commission, its report on various problems in terms of controls, particularly on satellite technology. Congress decided that the State Department should assume responsibility for satellites. All satellites, even commercial satellites, became defined as military satellites just by sort of regulatory and statutory change, which resulted in decision flows and amendments being made into the ITAR.

Then there was a convention which required additional controls that had not been placed on Canadian and U.S. goods, but which we agreed to because we were both parties to that. So that led to amendments to the ITAR coming about almost a year ago today. They were published on April 12th, 1999, with changes to the Canadian exemption. But the Canadian exemption was changed in ways that went beyond those necessitated by firearms controls and by the movement of satellites onto the State Department's control. The scope of the exemption was narrowed. Canadian industry found itself, where it had been able to have access to U.S. goods through the use of the exemption, being denied that. Most critically, this is partly due to some regulatory change and partly due to a State Department re-interpretation of what the previous agreement meant; technical data was no longer being covered. So where goods may flow, the technical data could not, which practically meant that Canadian companies were in a position where they could not bid on projects.

This is particularly critical in Canadian industry who tend not to be manufacturing the big products, but tend to be bidding as sub-component suppliers with fairly short turnarounds. These bidders are looking for responses, say, within ninety days. They could not even send the bid package out to a Canadian company because they now needed State Department clearance. They were not going to get the clearance within the ninety days anyway. So those kinds of practical problems were having quite an impact on Canadian industry. There also was, and this is probably the most troublesome aspect, another re-interpretation by the State Department legal advisors that U.S. companies had really misunderstood who was a Canadian citizen.

The Canadian exemption basically read, since the early 1990s, that these goods could flow into Canada if they are intended for use in Canada by a Canadian citizen. When you talk about Canadian citizens, it means Canadian workers in plants. It was decided that, if that person in Canada happened to be a Canadian citizen and a citizen of another country, then the Canadian exemption did not apply. They had to be looked at in terms of their other citizenship. Canada does not require the renunciation of another citizenship; we have not required that for twenty-five years. We have a high number of immigrants in Canada. There probably is not a major industry in Canada that

does not have many dual citizens. Fifty percent of the population in metropolitan Toronto was foreign-born, most of whom would bear dual citizenship.

This really gutted, in effect, the Canadian exemption and has created tremendous difficulties for us. It has been a matter of very high level attention since it occurred. It was a matter for fairly constant discussions at the administrative level since even before the publication of the changes one year ago. Within ten days of the changes being published, there was a joint statement arising out of a meeting between Minister Lloyd Axworthy and Secretary of State Madeline Albright where it was agreed that we would work together on trying to restore the balance in the relationship, to mitigate the effects on Canadian industry, but at the same time, preserve what we all recognized were some serious security concerns for the United States and the need on the Canadian part to address some of these concerns.

Despite this focus on moving forward and quickly working out the details, as is always the case in these situations, it has proved very, very difficult. We labored in meetings taking place at fairly high levels through the spring and summer. A lot of progress was made, but some very serious meddlesome issues continued, particularly on the dual citizen issue.

In October of 1999, President Clinton made a trip to Ottawa. There was really a focused attempt on the part of officials to get this issue out of the way. They wanted to use the attention that it was getting from very senior levels on both sides of the border, particularly for Canada which was finally getting more consistent senior level attention to resolving this dispute. At the time of the President's visit, there was a joint statement issued by Minister Axworthy and Secretary Albright that re-affirmed a lot of what was really critical. There was a joint commitment to control the sensitive technology that was under concern whose very nature was far from being just big, heavy, clunky machinery that customs inspectors could spot.

Many of the concerns were geared toward technical data, as I alluded to, information that could be easily stored in different mediums. It presented a different scale of problems. You did not have nice, neat agreed-upon enemies where the COCOM could sit down together and say, here is the Warsaw Pact over here. We understand who the players are, and how these things are being controlled. It was just a different environment.

There was more of a need to recognize, particularly on the Canadian side, that we had to adapt more. We committed ourselves to regulatory changes that would bring our system more in line with yours. It was quite rightly pointed out that, because of gaps in the system that allowed U.S. goods to flow into Canada without controls on exports on our general undertaking, that we would not allow re-export to areas that would be of concern to the

United States. In fact, some of those goods were not controlled by us as an export matter. There were some gaps that needed to be filled. In return for that, the idea would be that there would be a restoration of some form of Canadian exemption that worked. On the issue of citizenship, what you are really talking about is a security issue. We were not prepared to treat a person as a security risk on the basis of nationality, *per se*. That is just not on legally. It is not on politically. It just is not really acceptable. Certainly at the very high level, that was understood. The goal of the United States was enhanced security. But, in terms of working out the details of this, it has proved very difficult.

But we have been making progress. We have met a number of times. We are close to saying that there will be a structure in place, which will address the concerns on the American side. They will address concerns that, in working through this process, we have identified weaknesses in our own system that we would have had to fix anyway. We will take on a regulatory burden, it would seem, and impose some costs in our industry to address U.S. security concerns in ways, perhaps, we would not have done if we would have been on our own.

It basically relates to the citizenship issue. As I said, we were not prepared to go as far as to say that persons of a particular nationality, *per se*, are a problem. But we do recognize that there is a need to have a capacity to track sensitive technologies that are exported to the United States that are in Canada. They are being used in our defense industries primarily for re-export into the United States. We needed to know, where are these technologies? Where are these goods? Who has access to them? Is it secure? So, as the resolution of this dispute is shaping up, it will probably result in a form of registration for Canadian users of these types of sensitive U.S. technologies. The model we are looking at is an expansion of two security programs, the Industrial Security Program, which deals with classified material, and the Joint Certification Program, which is a Canada-U.S. program which allows certain other technologies to go to registered users.

The model we will probably use would have these goods going within Canada to registered users. These big companies would be valued in some way for security, and they would take on the responsibility of the secure handling of the goods and technologies and being accountable for them. In many cases, these companies do that anyway for their own commercial reasons. But this will shift some burden, create some costs, impose some burdens in the form of employee screening. The screening will not be focussed on nationality. That may be a factor for certain nationalities and certain individuals. But certainly a number of cases on technology in the United States have not involved foreigners. They have involved domestic

citizens, one hundred percent true blue, who just got seduced by some other reasons.

This will create problems, but we are prepared to take on some of those, because they will address some of those security concerns. They will re-affirm the Canadian commitment to a common North American defense and a common North American defense industrial base. With these changes, we hope to resolve what has been a very prolonged negotiation, bedeviled by much wrangling over details. It has led to my sitting with engineers who were talking about things that I had no idea what they meant. The Canadian exemption, which was about one page, will probably emerge, even in its agreed form, at six or seven pages of U.S. regulatory language. As part of the package, we have insisted the United States issue explanatory notes of some kind, because, frankly, it is difficult to tell just what is being covered. But we hope that there will be, at the end of this process, a re-affirmation of cooperation in this field; that there will be joined efforts at reaching out to the industries, both in Canada and the United States, in saying, this is the regime. Both governments agree on it and maybe we can wrap up this episode on a high note.

I would have hoped to have been standing before you today to be able to announce that. I am not in a position to do that. Though perhaps within months we will be in a position to say that another Canadian-U.S. dispute has been resolved after protractive negotiations. A little good will and a lot of high level attention, have helped to drive the process. So, I will turn it back to Terry, but certainly I am prepared, after some of his remarks, to take on some of the questions you might have.

