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Briefing Report to the Chairman, Subcommittee on Europe and the Middle East, Committee on Foreign Affairs, House of Representatives

January 1986

ARMS EXPORT CONTROL ACT

Purpose and Use of Selected Provisions

GAO/NSIAD-86-46BR

UNITED STATES GENERAL ACCOUNTING OFFICE
WASHINGTON, D.C. 20548

NATIONAL SECURITY AND
INTERNATIONAL AFFAIRS DIVISION

B-221586

January 15, 1986

The Honorable Lee H. Hamilton
Chairman, Subcommittee on Europe
and the Middle East
Committee on Foreign Affairs
House of Representatives

Dear Mr. Chairman:

This report responds to your August 12, 1985, request that we examine certain Arms Export Control Act (AECA) provisions designed to improve defense cooperation with NATO allies. As agreed with your office, we focused on each provision's intended purpose, examples of how the provisions have been applied, and the extent they have been used.

The following table summarizes pertinent data on the AECA legislative provisions cited in your request.

AECA section	Pertains to	1985 amendment	Special treatment for	Waivers or reduced costs	Reciprocity or other benefits required	Congressional reports
27	Cooperative agreements	Yes	NATO only	Yes	Yes	Yes
21(e)(2)	Nonrecurring cost	No	NATO and select countries	Yes	Yes[a]	Partial[b]
21(g)	Training	Yes	NATO and select countries	Yes	Yes	Yes
21(h)	Various DOD services	Yes	NATO only	Yes	Yes	Partial[c]
30A	Training	Yes	All	Yes	Yes	Yes
36	Congressional reports	Yes	NATO & select countries	Not applicable	Not applicable	Yes

[a]Additional benefits required by DOD policy, not by law.
[b]Not legislatively mandated.
[c]Title 10 reporting requirements provide some information on cataloging services.

These sections provide for special treatment of NATO countries to advance rationalization, interoperability, and standardization while sharing costs (several apply to mutual defense pact partners as well). Only section 30A extends beyond NATO and selected countries and applies to all allied and friendly nations. For the most part, these provisions are administered within the existing foreign military sales (FMS) system. The major exception is section 27, which was intended to promote cooperative projects with NATO nations. A 1985 amendment to section 27 permits arms transfers outside of the existing FMS process and, with other administration and congressional actions, is expected to encourage greater use of cooperative projects.

It is very difficult to measure the benefits of these provisions--especially their contributions to alliance standardization. Most of the provisions do call for reciprocity, at least in principle, when extending benefits to NATO and other nations. The provisions do not require a "dollar for dollar" exchange. The United States often provides more benefits than it receives, because it usually sells more military equipment or provides more training to foreign countries than it buys or receives.

Each provision is discussed in detail in the attached appendixes.

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The information we developed is based on an examination of the legislative provisions and history, prior GAO reports, review of pertinent literature, and discussions with knowledgeable officials within the Departments of Defense and State, and outside of government. Time constraints did not permit us to obtain official comments on this report. We did, however, informally discuss its contents with appropriate administration officials.

Unless you publicly announce its contents earlier, we plan no further distribution of the report until 15 days after its issue date. If you have any questions, call me on (202) 275-4128.

Sincerely yours,

Joan M. McCabe

Joan M. McCabe
Associate Director

Contents

WAIVER OF NONRECURRING COSTS AND ASSET USE CHARGES SECTION 21(e)(2), AECA

Section 21(e)(2) of the Arms Export Control Act (AECA) of 1976 authorizes the President, in making sales of defense articles or services, to reduce or waive charges for the use of plant and production equipment (commonly referred to as asset use) and for a proportionate amount of any nonrecurring costs of research, development, and production of major defense equipment.[1] Specifically, the President may grant waivers to eligible countries in connection with sales that ". . . significantly advance United States Government interests in North Atlantic Treaty Organization standardization, standardization with the Armed Forces of Japan, Australia, or New Zealand in furtherance of the mutual defense treaties between the United States and those countries, or foreign procurement in the United States under coproduction arrangements." The authority for making these waivers has been delegated to the Secretary of Defense and, in turn, to the Defense Security Assistance Agency (DSAA).

Originally, only North Atlantic Treaty Organization (NATO) members were eligible for exemption from paying asset use charges and nonrecurring costs by this provision. In 1981, the President's authority to waive these charges was extended to include Japan, Australia, and New Zealand. According to a DOD official, the three non-NATO countries were exempted in response to their complaints of not being treated with the same status as the United States' NATO allies. For all other countries, these costs are to be fully recovered.

VALUE OF WAIVERS EXTENDED

According to information provided by DSAA, about $1.38 billion in charges and fees have been waived for nonrecurring research and development costs between fiscal year 1981 and July 15, 1985. The number and value of waivers approved vary from year to year depending on the type, quantity, and cost of equipment purchased by foreign countries.

The number of nonrecurring cost waivers approved by DSAA since fiscal year 1981 is shown in the table below. According to DSAA, no nonrecurring cost waivers have been extended to Japan.

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[1]"Major defense equipment" refers to any item of significant military equipment on the U.S. Munitions List having a nonrecurring research and development cost of more than $50 million or a total production cost of more than $200 million.

APPENDIX I

Table I. 1: U.S. Nonrecurring Cost Waivers

Country	Fiscal Year 1981	1982	1983	1984	1985[a]	1981-85[a]
	(thousands)					
Australia	$ 878	$ 45,975	$ 4,207	$ 4,841	$ 188	$ 56,089
Belgium	352		28,160	95		28,607
Canada	74,377		251	71		74,699
Denmark	661	1,626		54		2,341
France	600		23,463	246		24,309
W. Germany	1,843	900	52,819	530	129,937	186,029
Greece		35	2,382	95		2,512
Italy				11,732		11,732
Netherlands	6,282	2,297		29,515		38,094
New Zealand		30				30
Norway	13,844	530		4,553		18,927
Portugal		104	376	66		546
Spain			42,173		588	42,761
Turkey	3,815	3,943	9,673	7,137	132,667	157,235
United Kingdom	86,737	575,699	35,867	42,088		740,391
Total	$189,389	$631,139	$199,371	$101,023	$263,380	$1,384,302

[a]As of July 15, 1985.

Source: DSAA

DSAA could not provide similar information on the waivers associated with asset use because cumulative information is not available.

DOD institutes policy of seeking additional benefits for waivers

The AECA does not require that Department of Defense (DOD) seek additional benefits beyond standardization when reducing or waiving nonrecurring costs. The act, however, does not define standardization benefits, a term which, according to a DSAA official, defies a precise definition.

According to DSAA, it is DOD policy to obtain other benefits in addition to standardization when waivers are granted. DOD's policy requires a presumption against waivers unless such benefits can be demonstrated. These benefits to the United States can be directly related to the product being procured or can involve an activity or service in return which is totally unrelated to the foreign country's purchase.

Only Military Assistance Program (MAP) recipients are excluded from DOD's policy on receiving additional benefits. The countries eligible for nonrecurring cost waivers that are also current MAP recipients are Portugal and Turkey.

The Assistant Secretary of Defense for International Security Policy initiated the activities resulting in the 1982 policy that DOD seek additional benefits beyond standardization when considering nonrecurring cost waivers. In June 1982 an internal DOD memorandum from the Assistant Secretary of Defense for International Security Affairs pointed out that significant congressional criticism had been levied against DOD for excessive use of its nonrecurring cost waiver authority. The criticism was the result of waiving virtually all charges for eligible countries. The Assistant Secretary was not satisfied that the legislation made sense because wealthier countries, such as most NATO nations, received waivers while poorer (noneligible) countries did not. In his opinion, the legislation overemphasized NATO standardization as opposed to many other aspects of security assistance relationships.

According to DOD's Security Assistance Management Manual (as of January 10, 1985):

> ". . . Full waivers solely on the basis of standardization may be granted to eligible countries for which Military Assistance Program (MAP) funding has been approved for the current fiscal year. . . For all countries and organizations other than those specified in the preceding sentence, there will be a presumption against granting a waiver unless additional or unusual benefits can be demonstrated. Such benefits must be clearly identifiable and generally attributable to a unique military, foreign policy, or economic advantage of the sale. A description of such benefits will be included in documentation relating to the case."

A cording to a DSAA official, responsibility for individual waiver negotiations may be decentralized within DOD. They might be conducted, for example, by the individual services as a part of broader negotiations or from within the Office of the Secretary of Defense. In addition, negotiations have not always been completely documented.

DSAA could provide no summary documentation whereby we could readily determine or independently assess the total extent to which DOD sought and/or received additional benefits. Based on cases we selected, DSAA provided information which showed that additional benefits were sought and received as a condition of granting nonrecurring cost waivers, asset use charges, and administrative surcharges. In two examples where this was not the case, DOD explained that the procurements preceded the DOD policy. In the information provided on pages 4 and 5, the degree and value of reciprocity cited reflect DOD's evaluation of the benefits received.

United Kingdom procurement of harpoon missiles, sub-harpoon missiles, and harpoon launcher systems

Waiver:	100 percent of nonrecurring costs not to exceed $23.1 million, depending on the number of units ultimately purchased. An additional $5.3 million in asset use charges was waived for the sub-harpoon missile. (Waivers authorized in fiscal years 1982 and 1984.)[2]
Rationale and additional benefits:	In return, the United Kingdom (U.K.) agreed not to seek any research and development cost recovery on Royal Navy improvements to the sub-harpoon launcher which the U.S. Navy might acquire for its own use. The United States sought but did not receive similar U.K. waivers for any possible U.S. Navy acquisitions for third country sales. According to U.S. Navy calculations, the amount invested in improvements by the United Kingdom (to meet its own requirements) that were also applicable to the U.S. Navy resulted in benefits comparable to the amounts waived by the United States. These and other investments-in-kind were cited by the U.S. Navy as numerous and exceeding the benefits of standardization.

United Kingdom procurement of CH-47 helicopters

Waiver:	100 percent of nonrecurring costs not to exceed $600,000. (Waiver authorized in fiscal year 1982.)
Rationale and additional benefits:	No information on additional benefits being sought or received by DOD. According to DSAA, the U.K. application was received prior to the institution of DOD's reciprocity policy. A later U.K. application for a waiver of $200,000 for two additional helicopters was denied because of "insufficient justification to substantiate a waiver." According to DSAA, this application was denied because the increased purchase involved use of the equipment outside the NATO area.

Australian procurement of up to six Recovery Assist Secure and Traverse (RAST) systems

Partial waiver:	Nonrecurring costs not to exceed $225,582 were waived, or 36 percent of total U.S. portion (the cost of development is jointly shared by the

[2]In this and subsequent examples, the years in which waivers were authorized may not reflect the years in which the actual procurements take place.

United States and Canada). (Waiver authorized in fiscal years 1984 and 1985.)

Rationale and additional benefits: The RAST system is to be installed on a frigate which Australia purchased from the United States. The same waiver of 36 percent of the nonrecurring costs granted in the sale of the frigate itself was extended to the RAST system. According to DSAA, since the RAST procurement involves modification to equipment (the frigate) which was procured prior to DOD's policy, no additional benefits were sought in this case.

Italian procurement of up to 6,000 Maverick Missiles

Partial waiver: 50 percent nonrecurring costs not to exceed $11,433,000 waived, or 50 percent of the total. (Waiver authorized in fiscal year 1984.)

Rationale and additional benefits: The Maverick program is a European coproduction effort headed by Italy. While DOD policy normally does not provide for waivers on coproduction programs, a reduction of 50 percent of nonrecurring costs was made on this program to recognize the European consortium efforts to achieve a missile which will be interoperable with standard U.S. equipment rather than pursue independent development, and to recognize Italy's past support of other U.S. initiatives. According to a DSAA official, information on this latter point was too sensitive to release.

United Kingdom procurement of Joint Tactical Information Distribution System (JTIDS) terminals

Waiver: 100 percent of nonrecurring costs not to exceed $16.5 million. (Waiver authorized in fiscal year 1983.)

Other: The United States deferred a decision on waiving costs associated with asset use.

Rationale and additional benefits: According to DOD, the waiver was fully offset by an estimated direct cost savings to the United States of $13 million (mostly from engineering change proposal sharing) and indirect cost savings of $11 million (mostly from support work and systems studies).

DOD denials of nonrecurring cost waiver applications

We saw over a dozen documented examples of DOD's policy to refuse requests for waiver of nonrecurring costs because tangible benefits were not demonstrated. Denials were sometimes made because the application for waiver was submitted after the

procuring country reached agreement with the United States on the sales. In these instances, DSAA explained to the foreign country that there is no authority to grant waivers retroactively. More often, denials of waiver applications were based on the country's failure to demonstrate benefits other than standardization and interoperability which, alone, are considered insufficient justification, by DOD policy, to support a nonrecurring cost waiver. In some letters to applying countries, DSAA has stated that further action on their requests for waivers is dependent upon identification of other reciprocal benefits. For example, one DSAA letter of denial concluded by stating that: "If you would identify to DOD reciprocal compensation for the Government of the United States or our mutual friends or allies, we would be glad to reconsider your requests for waiver of NRC [nonrecurring cost] charges."

CONCLUSION

As intended by section 21(e)(2), NATO and selected countries receive waivers of nonrecurring costs and asset use charges. The criterion required by this provision, in considering waiver requests, is that the sale significantly advance U.S. interests in standardization, a term which, according to a DSAA official, defies precise definition. Since 1982, DOD has gone beyond this criterion by instituting a policy seeking additional benefits to the United States. DSAA provided examples of instances in which waiver applications were approved and denied based on the standardization requirement as well as on the basis of additional benefits. Because DSAA lacked complete documentation on negotiations relating to additional benefits, we were not able to determine whether the policy is consistently applied.

QUALITY ASSURANCE, INSPECTION, CONTRACT ADMINISTRATION, CONTRACT AUDIT, AND CATALOGING DATA AND SERVICES SECTION 21(h) AECA

Section 21(h) was added to the AECA in 1979, authorizing the President to provide, without charge, on a reciprocal basis, quality assurance, inspection, and contract audit services to individual NATO countries and the NATO Infrastructure Program.[1]

When legislation to enact section 21(h) was being considered, a Senate hearing disclosed that other NATO nations had, as a matter of policy, already agreed that quality assurance and inspection services would be provided without charge on procurements between member nations. The failure of the United States to adopt this policy was cited as a repeated source of friction within NATO. Also, enactment of the 1976 AECA had abrogated a long-standing reciprocal agreement between the United States and Canada for waivers of charges for quality assurance and inspection services.

CONTRACT ADMINISTRATION SERVICES (CAS)

When enacted in 1979, section 21(h) cited only quality assurance, inspection, and contract audit services as qualifying for waiver under reciprocating arrangements. However, DOD initially interpreted section 21(h) to include CAS, which encompasses quality assurance and inspection services, and other functions such as contract and financial management, data and production management, and industrial security. According to one official, DOD's interpretation was based on the fact that quality assurance is a significant part of CAS, but a DOD legal interpretation ruled that section 21(h) was limited to the services specified. The legislation was amended in August 1985, extending the reciprocal waiver provision to specifically cover CAS, as well as cataloging data and services (these latter services are separate from CAS).

CAS is performed by military service and Defense Logistic Agency (DLA) contract administration offices. CAS is provided on behalf of foreign-country FMS customers, or upon request when foreign countries buy commercially from U.S. defense contractors. Contract audit services are a CAS-related function and are usually provided by the Defense Contract Audit Agency.

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[1]This commonly funded military construction program is designed to provide essential operational facilities and equipment in support of NATO's military forces. See GAO report, U.S. Participation in the NATO Infrastructure Program, GAO/ID-83-3, Jan. 27, 1983) for a more complete discussion of this program.

Reciprocating arrangements

At the time of our review, agreements had been in effect with the following NATO countries/organizations for reciprocating quality assurance, inspection, and/or contract audit services: Belgium, Canada, Denmark, France, Germany, Italy, Netherlands, and the United Kingdom; European Participating Governments, NATO Infrastructure Program, and NATO Integrated Communication System Management Agency.

Comprehensive information was not available to indicate the extent to which these services have been provided reciprocally as authorized by section 21(h). Some information was available on CAS provided to direct commercial customers, but for FMS cases, DOD officials told us information is not routinely tracked or readily available--a case-by-case analysis of transactions would be required to determine the reciprocal services provided by the United States. Data on services provided to the United States reciprocally were also not available. However, in an April 5, 1985, memorandum, the DOD Deputy Under Secretary for Acquisition Management instituted an annual reporting requirement for information on CAS services provided by DLA and by foreign countries under reciprocal agreements. The reports are to be completed by February 15 of each year beginning in 1986. The data are intended to provide work-load statistics on services received and provided.

CATALOGING SERVICES

Cataloging services are an important element in supporting NATO standardization and in providing logistics support. Cataloging provides a common language used in identifying, requisitioning, purchasing, storing, and shipping needed parts and other supply items. The adoption of standard item names and descriptions and a uniform numbering system facilitates supply actions. Common item identification is provided for items procured by foreign governments in the United States and likewise for items procured by the United States from foreign sources. The United States currently has bilateral agreements for exchanging catalog data with all NATO nations, except Italy, Luxembourg, and Iceland.

DLA is responsible for administering the U.S. cataloging program; it provided us with information indicating the extent of reciprocity in cataloging transactions between the United States and other NATO countries.

Table II.1: Cataloging Transactions Between the U.S. and Other NATO Countries
(Period Covered: 1984 through September 1985)

	Cataloging requests[a]	Maintenance requests[b]	Interrogations[c]	Catalog-related publication requests
By NATO countries	86,923	698,947	361,491	3,429
By the United States	1,475	2,006	1,501	35

[a]Involves the exchange of data and assignment of stock numbers.
[b]Involves updating data, i.e., adding, deleting, and making changes to catalog data.
[c]Involves inquiries regarding catalog data.

A DLA official said that a major factor behind the United States giving more than it receives is that the United States enjoys a favorable balance of defense trade with NATO countries.

A condition stipulated in the August 1985 legislation was that cataloging services could be provided without charge only by reciprocal arrangements. DLA officials told us that prior to the legislative enactment, NATO countries, except for France and the United Kingdom, were not charging for these services. The fact that United States was not reciprocating had become a source of friction with some NATO countries.

Charges by the United States for cataloging services totaled $850,000 in 1982, according to information provided in a 1985 Senate report. The administration justified the need for the 1985 legislation in terms of reducing a sizable administrative burden--there were a large number of minor transactions relative to the amount of money involved.

CONCLUSION

Section 21(h) is based on the principle of reciprocity, but only limited data are available to indicate the extent to which it takes place. However, given that the United States sells more defense equipment to NATO countries than it buys from them, it can probably be assumed that the United States provides more services than it receives.

TRAINING: FULL COST PRINCIPLES AND WAIVERS UNDER SECTION 21(g) AND OTHER LEGISLATION

Under section 21 (a)(1)(C), the AECA authorizes DOD to sell training to foreign countries through the FMS program and generally requires that the full costs associated with providing this service be recovered. Full costs are waived, however, under various legislative provisions (for NATO nations, under 21(g)), and U.S. training is priced using several different costing principles. Although the most recent amendment to the AECA related to training is entitled "Full Costing of FMS Sales of Training" (Public Law 99-83 Aug. 8, 1985, section 108), there are, in effect, five different pricing schedules authorized by statute that can be used for foreign students sitting in the same classroom.

LEGISLATIVE BACKGROUND

In 1968, the Congress revised and consolidated legislation governing the sale of defense articles and services in the Foreign Military Sales Act. This revision required foreign countries to pay, in U.S. dollars, not less than the full value of the training provided. Subsequently, each service instituted pricing procedures according to its own interpretation of "value." In 1975, responding to congressional and GAO criticism, DOD issued specific guidance for pricing training. In September 1976, DOD changed its pricing procedures to effect a 20- to 30-percent reduction in tuition prices but, 6 months later, reinstated many of the costs previously excluded--an action that GAO reported as a major step toward providing for recovery of the full cost of training foreign students.

The Arms Export Control Act restated the requirement that foreign countries pay the full cost of training. The act also allowed the President to enter into agreements with NATO countries for furnishing training on a bilateral or multilateral basis and charge only direct costs provided that the financial principles of the agreements are based on reciprocity. In 1980, the AECA was amended to add Australia, Japan, and New Zealand to the NATO countries eligible for reciprocal training agreements at a reduced price. The act was also amended to allow countries receiving International Military Education and Training Program (IMET) grant training to purchase additional training under the FMS program at reduced rates through incremental pricing.

In 1984, the AECA provision which set up the separate pricing structure for NATO and selected countries was repealed in favor of incremental pricing for all foreign countries. In 1985, Congress reinstated the full cost pricing structure for some FMS cash customers over DOD's objections but continued to

allow reductions for IMET, MAP, and NATO customers. DOD's position was that U.S. allies charge on an incremental basis and that tuition prices to foreign students based on full costs in effect subsidize U.S. costs since all but the incremental costs would be incurred regardless of foreign enrollment. The Congress took a different point of view; mainly that a proportionate share of all costs should be shared equally regardless of whether the students are American or foreign. To charge only incremental costs to foreign students means that the U.S. taxpayer absorbs a disproportionate share of the burden--especially when considering that the United States provides much more training than it receives. This is essentially the position set forth in GAO's 1984 report on military training tuition rates.[1]

DOD continues to emphasize that costs alone do not sufficiently recognize the benefits accruing to U.S. foreign policy and national security interests associated with establishing a valuable channel for communicating and influencing those who hold or are likely to hold future positions of prominence within their countries.

TRAINING COURSE PRICES AND INFORMATION ON RECIPROCITY FROM NATO COUNTRIES

Section 21(g), reinstated in the AECA in 1985, allows for reciprocal training agreements with NATO and selected countries (Japan, Australia, and New Zealand) at reduced prices--only one of several ways to charge for training foreign students.

Shown in table III.1 are fiscal year 1984 comparisons of rates charged for various Army, Navy, and Air Force courses under FMS/NATO and full FMS pricing schemes. Although prices have generally risen since 1984, the relationship between the two pricing categories remains similar, according to DSAA staff.

[1]Tuition Rates Charged Foreign Governments for Military Training should be Revised, GAO/NSIAD-84-61, Feb. 21, 1984.

Table III.1: Selected Examples of FY 1984 Course Prices Per Students

Course title	FMS/ NATO	FMS/ Full
Army		
Ordnance Officer Basic Munitions Material Management	$ 12,598	$ 18,783
Mapping and Charting Geodesic Officer	10,712	11,477
Command and General Staff Officer	19,267	33,158
Army War College Fellow	28,895	61,616
Navy		
Infantry Training School	1,382	1,993
Naval Command College	23,541	35,288
Naval Staff College	18,750	25,082
Armed Forces Staff College	18,913	21,785
Air Force		
Pilot Instrument Training	64,780	86,170
Experimental Test Pilot Course	399,280	627,700
Electronic Warfare Operations/Staff Officer	6,600	10,340
Air War College	25,260	40,600

In 1977, the House Committee on Appropriations expressed concern about the reciprocal agreements noting that, historically, the United States had provided the vast bulk of the training. Because of its concern, the Committee directed DOD to keep the Committee informed as to the number of students trained, the types of training provided, and the costs. The first report was requested by March 1, 1978.

Partial information provided by DOD showed that while the United States waives about $17 million in training foreign students annually, about $2.7 million in training costs are waived each year for U.S. students by NATO countries. In our February 1984 report, we noted that the difference indicates that Defense appropriations absorb about $14.3 million annually in training costs. The difference results from various factors, including the nature of the training and the number of trainees.

The concept of a relative balance of training appears to be also recognized by NATO. In one of the Standardization Agreement's[2] clauses dealing with the prospects of entering into training agreements on a bilateral basis with the view of waiving charges altogether, NATO concludes by stating that "these arrangements will normally be based on the provision of an equitable balance of training between the nations concerned." (Underscoring supplied.)

The information used to calculate the balance of waivers given and received by the United States was based on two DOD reports, one for the 15-month period ending December 31, 1979, and the other for the 6-month period ending September 30, 1981. More recent reports were not available to update this information.

OTHER PRICING CATEGORIES

In addition to a separate pricing category established for NATO nations, several other categories are used which result in prices substantially less than those designed to recover full costs. These are briefly described below along with a table showing the cost composition of all categories.

(1) International Military Education and Training Program - provides professional military training on a grant basis to selected foreign military and related civilian personnel both in the United States and in overseas facilities. Legislative authority is found in the Foreign Assistance Act of 1961, as amended. Only the incremental, or "additional," costs incurred by the United States in providing training simultaneously to U.S. and foreign military students are charged.

(2) FMS/Military Assistance Program - provides grant funding for procuring defense articles and services. MAP was established under the Mutual Defense Assistance Act of 1949, but beginning in fiscal year 1982, authority under the Foreign Assistance Act has been used for the merger of MAP and FMS funds, thus making MAP funds available for the

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[2]The United States is signatory to NATO Standardization Agreement 6002 (with reservations), which governs "Principles and Procedures for the Conduct and Financing of Training Assistance".

financing of countries' FMS cases. The price charged is based on incremental costs plus an administrative surcharge normally associated with FMS cases.

(3) FMS/IMET - provides training purchased by countries receiving FMS IMET funds. AECA authorizes an IMET price modified to recover some costs normally charged under FMS, such as military salaries, entitlements, and an administrative surcharge.

(4) FMS - the price charged all others; provides for full cost recovery and is developed on the premise that the United States will neither make nor lose money in any FMS undertaking. Authority is provided in AECA, section 21(a)(1)(C).

Table III.2: Cost Elements Used in Establishing Tuition Rates[a]

	Tuition rates				
		FMS			
	IMET	MAP	IMET	NATO	Full
Direct costs:					
Civilian labor	*[b]	*[b]	*[b]	x	x
Civilian retirement	o[b]	o[b]	o[b]	x	x
Military labor	o	o	*	x	x
Military retirement	o	o	o	x	x
Materials/other	*	*	*	x	x
Informational program	x	x	x	x	x
Indirect costs:					
Civilian labor	*	*	*	o	x
Military labor	o	o	*	o	x
Materials/other	*	*	*	o	x
Asset use charge	o	o	o	o	x
Administrative[c] surcharge	o	x	x	o	x

x=full cost o=not charged *=incremental cost

[a]Adapted from Tuition Rates Charged Foreign Governments for Military Training Should be Revised, GAO/NSIAD-84-61, Feb. 21, 1984.
[b]DOD officials explained that it is the unfunded portion of civilian retirement costs that is not included.
[c]The surcharge is not an exclusive element of tuition; rather, it is an FMS transaction charge.

The rates for any particular course differ because various cost elements are excluded from some rates and others are charged only on an incremental cost basis.

CONCLUSION

With the exception of IMET, all training is purchased through the FMS system. Although there is a separate pricing mechanism under the FMS system for NATO nations, it is only one of five ways used to price U.S. training to foreign participants. Three of the five mechanisms result in prices lower than those charged NATO nations.

In principle, reciprocity is required when the United States waives costs to NATO members. The value of total waivers given foreign countries by the United States is much higher than that received, according to the latest DOD reports available.

EXCHANGE OF TRAINING AND RELATED SUPPORT SECTION 30A, AECA

Section 116 of Public Law 99-83 (Aug. 8, 1985) added the AECA section 30A to permit the President to enter into agreements or other arrangements to provide field training and related support to military and defense personnel of a friendly foreign country or an international organization. The recipient foreign country or international organization must reciprocate by providing similar training and support to U.S. personnel within a year of receiving training or by reimbursing the United States for the full cost of services to its personnel.

The amendment establishes an annual reporting requirement to the Congress on the activities and costs under this section. The reports are to cover the preceding fiscal year and the first is to be provided by February 1, 1987.

SECTION 30A LEGISLATES PREVIOUS ARMY PRACTICES

According to DSAA and Army officials, the training and support authorized under section 30A will be used only to implement unit exchanges. Typically an exchange may involve company-sized units, but there is no unit size restriction. The duration of the exchange for active Army units is expected to be 4 to 6 weeks while that for reserve components is 2 weeks.

The primary benefit is to help training units become familiar with host units' environment, tactical doctrine, operations, and equipment. Additional benefits of unit exchanges include:

--providing interesting and challenging training opportunities, including incentives for individuals to be selected for the exchange,

--improving bilateral relations, and

--aiding in the sharing of expertise.

Although legislatively new, the exchange of training and related support has occurred within the Army at least since 1974 through a regulation entitled "Exchange of Small Army Units Between the United States and Allied Nations for Training" (Army Regulation 350-11). Historically, there have been about 25 to 30 unit exchanges annually, according to an Army spokesperson. Typically, they involved countries such as the United Kingdom, Canada, Norway, Australia, and various Caribbean nations. In many instances the training involved simultaneous exchanges; for example, a U.S. unit would be flown to a foreign country for training and the same U.S. aircraft would be used to transport the foreign troops to a U.S. facility. At the conclusion of the training, a foreign country's aircraft would return the U.S. troops and transport their own troops back home.

According to an Army official, these small unit exchanges had been conducted under Memoranda of Agreement, but this training was terminated in March 1984 after a legal review concluded that such exchanges should fall within the specific authority of the sales provisions of the AECA. Also, many countries objected to the required exchange of funds mandated by an FMS case. Apparently their internal procedures would not permit funds received from the United States for providing training to U.S. units to be credited to their defense budgets, although their defense departments expended funds to obtain U.S. training. The amendment to the AECA allowing an exchange of units without an exchange of funds (unless reciprocity is not received) effectively addresses this problem.

U.S. ARMY HAS LEAD RESPONSIBILITY

Since the Army has had experience with unit exchanges of the type authorized by section 30A, it was assigned to take the lead and draft separate standardized implementing regulations to include uniform international agreement and report formats. Once developed, these Army regulations will be used by the other services in drafting their own regulations. As of January 1985, the Army regulation had not been finalized but will most likely follow previous regulations except to incorporate the additional procedures and reporting requirements necessary to comply with the legislative provision.

CONCLUSION

Essentially, this amendment legislates previous Army practices. To the extent that reciprocity is achieved, this exchange program will function outside the FMS system.

COOPERATIVE PROJECTS SECTION 27, AECA

NATO countries have been critical of what they perceive as a favored status of the United States in the buyer/seller relationship created by U.S. foreign military sales and have been seeking more of a partnership where they are sharing some program costs. Legislative encouragement to foster joint participation in research and development programs leading to production of common use defense equipment was provided by section 27 of the AECA enacted in 1979. According to DOD officials, amendments in 1985 gave increased emphasis to the little used section 27. This legislation defined the term "cooperative project" to provide for joint production without requiring joint participation in preceding phases of the acquisition cycle, e.g., research and development (R&D). The 1985 amendments also provided for transfer of production items to participating allies outside of the FMS process. The 1985 legislation was supplemented by a revision to Title 10, United States Code, allowing waivers to certain U.S. procurement laws in initiating contracts under section 27. That legislation, by some accounts, would potentially allow for more alliance sharing in contract awards through new authority to assign subcontracts, and could provide economic incentive for greater alliance cooperation.

DOD has not yet devised implementing procedures for the new legislation, and it is too soon to tell to what extent it is apt to be used, and whether it will promote greater cost sharing in producing common use defense articles within the NATO alliance.

AECA amended by section 27

Section 27 cooperative projects between the United States and one or more NATO countries were to be based on the principles of cost sharing and on standardization and interoperability of allied armed forces. The 1979 legislation provided for partial or complete waivers of certain charges for sales by the United States related to a cooperative project if the other participating countries reciprocated by waiving comparable charges for their sales. The waivers involved investments in R&D, plant and production equipment, and administrative service costs--charges the United States normally assesses on FMS transfers of defense articles to customers who were not participants with the United States in developing the sale items.

According to DSAA's Office of General Counsel, an indispensable requirement of section 27 cooperative projects was cost sharing of R&D while joint production was not considered essential. Further, the DSAA Office of General Counsel and DOD officials stated that DOD lacked authority to enter into a cooperative production venture outside of FMS. Thus, section 27, as implemented by DOD, required that any production of an

item by the United States developed under cost-sharing R&D was to be handled as a FMS case, where the United States was contracting on behalf of NATO participants.

Congressional hearings preceding the legislation disclosed that NATO allies objected to aspects of the FMS system, such as charges for R&D, plant and production equipment, and what they termed artificial administrative costs being applied when cooperatively developed items went into production, and to the favored status they believed accrued to the United States once a project transitioned into FMS. However, while the legislation provided for waivers (most of which were already allowable under 21(e)(2), it did not depart from the FMS system and its implied seller/buyer relationship. Furthermore, NATO countries objected to controls over third-country transfers and delivery schedules, and some mandatory contract clauses such as those involving gratuities, limitations on agents' fees and commissions, preference toward U.S. flag vessels and air carriers, and others considered foreign to practices of European countries. Also cited were the justification procedures an FMS customer must follow to request a sole-source contractor.

Limited use of section 27

Since 1979, only seven section 27 projects have been reported as required by the Congress. They are:

(1) development of commonly approved changes to the Roland missile system (1980),

(2) establishment of a family of advanced air-to-air missile systems (1980),

(3) development of engineering to integrate the CFM-56 turbofan engine with the KC-135 and French C-135F aircraft (1981),

(4) establishment of a joint program to initiate concept definition for a terminal guidance warhead for the multiple launch rocket system (1981),

(5) establishment of a joint program to develop and ultimately produce a terminal guidance warhead for the multiple launch rocket system (1983),

(6) development, production, and support involving the AV-8/B Harrier GRS (1981), and

(7) initiation of a feasibility study of a NATO frigate replacement for the 1990's (1984).

The limited use of cooperative projects was not only related to dissatisfaction with U.S. requirements. Agreements on cooperative projects are not easily or quickly concluded, and in attempting to do so several factors come into play. For example, such projects involve a joint sharing of cost and the ability of participating countries to agree on design, to match funding requirements with their respective budget cycles, and to remain committed in the face of competing budget priorities.

RECENT LEGISLATION

Legislation was recently enacted which deals directly with some of the problems cited above and which may have much symbolic importance in gaining NATO allies' acceptance of cooperative projects. The International Security and Development Act of 1985 (Public Law 99-83, Aug. 8, 1985) amended section 27 of the AECA regarding the definition and use of cooperative projects. Specifically, a cooperative project is defined as a "jointly managed arrangement described in a written agreement among the parties, which is undertaken in order to further the objectives of standardization, rationalization, and interoperability of the armed forces of the North Atlantic Treaty Organization member countries and which provides--

(A) for one or more of the other participants to share with the United States the costs of research on and development, testing, evaluation, or joint production (including follow-on support) of certain defense articles;

(B) for concurrent production in the United States and in another member country of a defense article jointly developed in accordance with subparagraph (A); or

(C) for procurement by the United States of a defense article or defense service from another member country;..."

The legislation permitted the transfer of production items to cooperating NATO allies outside of the previously required FMS process and also permitted cooperative projects that did not begin with joint R&D. In addition, the fiscal year 1986 Defense Authorization Act (Public Law 99-145, Nov. 8, 1985) provided for a new section to be added to chapter 141 of Title 10, United States Code, authorizing the Secretary of Defense, with exceptions, to waive procurement provisions mandated by law for contracts outside the United States, and to assign subcontracts to particular subcontractors in connection with cooperative projects.

QUESTIONS CONCERNING THE RECENT LEGISLATION

This legislation, along with other recent congressional and administrative actions[1] encouraging greater NATO arms cooperation, is seen by U.S. and NATO sources as encouragement to use cooperative projects. Emerging technologies and a few cooperative programs nearing or at production are frequently cited as likely candidates for new section 27 projects.

Potentially on the downside, some questions have been raised about the impact of the 1985 changes on U.S. costs, U.S. control over arms transfers, and on U.S. industry.

DOD has not yet issued implementing procedures, and it is too soon to gauge the effect the revised legislation will have on cooperative projects.

Some questions raised

- The revised section 27 introduces the concept of equitable sharing whereas it previously referred to "cost sharing among the cooperating parties." Equitable sharing is described in the legislation as including funds or defense articles or defense services. Views have differed as to whether the term "equal" should have been used versus "equitable," and questions have been raised as to how one defines what is equitable. (Under section 27, information regarding contributions of participants to each cooperative agreement will be reported to Congress including dollar contributions and a description of the defense articles and services expected to be contributed.)

- Because the revised legislation provides the flexibility to include some or all phases from R&D through production and follow-on support, the question has been raised whether the provision would permit a NATO country to participate in joint production without participating in the R&D phase and without paying a fair share of development costs. (As discussed on p. 18, DOD had interpreted cooperative projects under prior legislation as requiring participation in R&D. One DOD official said DOD will continue to seek major investments by the cooperating parties, at whatever phase, in order to reduce U.S. costs.)

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[1]The fiscal year 1986 Defense Authorization Act (Public Law 99-145) also promotes cooperative efforts through reserving or "fencing" $200 million in fiscal year 1986 appropriations for NATO cooperative research and development projects, including side-by-side testing of conventional defense equipment manufactured by the United States and other members of NATO. Through memoranda and meetings, the Office of the Secretary of Defense is also placing new emphasis on cooperative projects with NATO allies.

- The new legislation authorizes a mechanism for cooperative agreements to encompass all phases from R&D to production, and provides for the transfer of production items outside of the present FMS process. Some speculate that this could result in a loss of control over arms transfers, particularly third-country transfers. (Although implementing procedures are not yet in place, a DOD official told us that the interagency approval process will be maintained both for initial and subsequent third-country arms transfers.)

- The recent amendment to Title 10, United States Code, to facilitate procurements under section 27 projects has raised a question as to preferential treatment for foreign countries/companies and the prospective impact on the U.S. industrial base. DOD officials responded that the legislation does not restrict assignment of contracts to foreign companies only. We found that a wait-and-see attitude prevails among government and industry sources contacted. It is generally recognized that it will not be so much the basic legislative provisions but how they are implemented that matters the most.

CONCLUSIONS

New legislation has been enacted giving increased emphasis to a little used provision existing since 1979, providing for cooperative projects intended to foster joint R&D and production of common use military items. The legislation adds a new dimension to arms transfer mechanisms by allowing for transfer of items under cooperative projects outside of the FMS process. This legislation, along with other administration and congressional actions may encourage greater use of cooperative projects; this includes earmarking appropriated monies for cooperative efforts.

CONGRESSIONAL CERTIFICATION OF MILITARY EXPORTS SECTION 36 (b) and (c)

The AECA provides for certification to the Congress of proposed FMS transfers and direct commercial sales of major defense articles, equipment, and services under section 36(b) and (c), respectively. Section 36(b) reduces to 15 days the period during which Congress can object to such FMS transfers to NATO, its member nations, as well as Australia, New Zealand, and Japan.[1] A 30-day period exists for other FMS nations, and all direct commercial sales. Section 36(b) also requires a report to Congress at least 45 days before delivery of an FMS major defense article, equipment, or service when the sensitivity of technology or the capability has been enhanced or upgraded from that described in the original certification.

CONGRESSIONAL CERTIFICATION OF MAJOR MILITARY SALES

The administration must submit to Congress a certification before selling any major defense equipment amounting to $14 million or more and defense articles or services amounting to $50 million or more. A third category--design and construction services valued at $200 million or more--applies to FMS only.[2] These certifications include information, such as the foreign country or organization to which major defense items are to be offered for sale; the dollar amount and number of items involved; a description of the items; and the U.S. department or agency making the offer. A statement describing the extent to which the items contain sensitive technology and a justification for their sale must accompany the certification.

Prior to 1981, section 36(b) and (c) stipulated that 30 calendar days had to elapse from the time the administration submitted a certification to Congress of a proposed transaction meeting the above criteria before a letter of offer and acceptance could be issued for an FMS transfer or an export license for a direct commercial sale. Additionally, DSAA provided Congress with at least 20 days advance notice prior to

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[1]Section 36(b) provides that a letter of offer to sell defense articles cannot be issued if, within the 15-day or 30-day period following certification, Congress adopts a concurrent resolution objecting to the sale. Such a provision amounts to a legislative veto which, as a result of the Supreme Court decision in Immigration and Naturalization Service vs. Chadda, 103 S.Ct. 2764 (1983) and later court cases, is regarded as unconstitutional.

[2]Major defense equipment was previously defined by footnote in appendix I, p. 1. Hereafter, this, as well as defense articles, services and design and construction services will be referred to as "major defense items."

the statutory certification to permit sufficient time for congressional review of a proposal.

The International Security and Development Cooperation Act of 1981 amended the AECA for NATO, Japan, Australia, and New Zealand, reducing the 30-day required certification review period to 15 calendar days and eliminating the 20-day informal review period. During congressional hearings on the proposed changes, administration officials stated that the special or separate treatment of NATO countries and other selected allies created by the amendment would have both practical and symbolic importance. That is, defense cooperation would be enhanced by reducing the process time for these countries, and allied resentment over being treated no differently than other foreign governments to whom the United States sells military equipment would be lessened. Except through discussions with administration and congressional officials, we were unable to identify, through available documentation, specific benefits achieved as a result of this amendment.

According to a congressional staff person involved in reviewing such certifications, the reduced time has not adversely affected the quality of the congressional reviews, since most proposed sales to these countries have been noncontroversial and therefore had been reviewed more quickly anyway than those to other countries.

The 1981 amendment did not change the 30-day review period for proposed direct commercial sales to certain NATO allies. We were not able to determine, either in the legislative history or from our DOD and congressional contacts, reasons for the difference in review periods for FMS and commercial sales.

SENSITIVITY OF TECHNOLOGY CERTIFICATION AND REPORTING

Congressional concern over the possible compromise of U.S. defense technology during the Iranian revolution was the primary reason for examining U.S. policies, during 1979 legislative hearings, governing control of sensitive technology. As a result, Congress required that the President undertake a thorough review of the interagency procedures and disclosure criteria used by the United States in determining whether sensitive weapons technology can be transferred to other countries. This review was then submitted to Congress. Recommendations to improve the disclosure system were included as well.

A 1979 amendment to section 36(b) required that arms sale certifications include a "Sensitivity of Technology Statement" regarding the extent to which the major defense items proposed to be sold contained sensitive technology. This requirement does not apply to direct commercial sales in section 36(c). As

was the case with certification of major military sales, no clear indication exists as to why commercial sales were not included in the amendments.

Congress chose to use the existing $14/$50/$200 million arms sale certification criteria as the threshold for agency submission of "Sensitivity of Technology Statements." According to congressional sources, the administrative burden of reporting on all defense items and services would be too unwieldy, for both congressional and agency arms sale reviewers.

Sensitivity of technology determinations

For the purpose of the reporting requirement, "sensitivity of technology" is defined by DSAA's Security Assistance Management Manual (SAMM) as "the extent to which the unauthorized disclosure or diversion of any equipment, technical data, training, services, or documentation required to be conveyed in connection with the proposed sale could be detrimental to the national security interests of the United States. The evaluation will address not only sensitive technological information contained in equipment components or technical documentation related to the sale, whether classified or not, but also restricted information contained in classified components or classified documentation required to be released in connection with the sale."

The sensitivity of a particular defense item is determined by the "owning" department or agency. Sensitivity assessments are done at the time a service receives a sale request. A review usually involves input from the project management office and laboratory where the technology is developed, as well as from the foreign intelligence office.

Beyond DSAA's definition, we found no other guidance or criteria to assist services in making such assessments. Representatives of the services with whom we spoke believe that the criterion "detrimental to the security interests of the United States" is open to subjective interpretation. Sensitivity, according to officials of one service, is in the "eye of the beholder." Army officials stated that they equate "sensitive technology" with "critical technology."[3] The Navy determines sensitivity on the basis of whether a technology appears on the Militarily Critical Technologies List, whether it is classified, or whether it is an advanced state-of-the-art technology.

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[3]"Sensitive" and "critical" are terms which emerged at the same time as a result of the AECA and the Export Administration Act, respectively. We found no documented explanation of the relationship between these two terms in the legislative history, through congressional sources, or within DOD.

Our discussions indicate that a sensitive article or service is not considered any less sensitive if sold to a country friendly to the United States. However, the degree of security protection that can be provided by a friendly recipient government is an important criterion included in an analysis of whether or not a particular arms transfer should occur. Other criteria, such as the effect on U.S. foreign policy, as well as the recipient country's needs, are also taken into consideration for the transfer of arms.

1985 amendment--
enhancements and upgrades

A 1985 amendment to section 36(b) requires the administration to expand the statement of sensitivity accompanying the certification of a proposed sale to include a detailed justification for selling major defense items containing sensitive technology. The amendment also requires advising the Congress at least 45 days before delivery of a major defense item[4] in which the sensitivity of technology or the capability is enhanced from that described in the original certification. The administration is also required to submit a new certification if the value of the enhancement or upgrade equals or exceeds the $14/$50/$200 million threshold. Both the the statement of sensitivity and report on upgrades and enhancements apply to any nation to which the United States sells arms and associated services. This requirement applies as well to NATO, NATO member nations, and Australia, New Zealand, and Japan. A major factor which prompted the 1985 amendment seems to have been congressional concern about the upgrade in the Saudi AWACs system, as well as the sale to Pakistan of F-16s with an advanced avionics package.

According to DOD's Office of the General Counsel, the meaning of the terms "enhanced" and "upgraded" is clear: a "demonstrative improvement" must exist in the sensitivity of technology or the capability of the major defense item described in the original arms sale certificate. This appears to reflect similar congressional intent. During a 1985 Senate floor debate, "enhancement" was construed to mean a change in "combat capability." The debate distinguished this from "every nut and bolt change that does not change combat capability."

CONCLUSION

The AECA provides a preference to NATO nations and certain other allies by reducing the time period during which Congress can object to a proposed major FMS transfer to any of these nations. This reduced review period does not apply to

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[4]To include electronic devices which, if upgraded, would enhance the mission capability of a weapon system.

commercial sales. We were unable to identify specific benefits derived from this amendment through available documentation.

We made three observations in the area of sensitive technology. First, the definition seems vague and open to subjective interpretation. We found no other guidance or criteria to assist the military services in determining sensitivity. Second, the legislative requirements regarding identification of sensitive technology do not apply to commercial sales. We were unable to determine why such sales were not included in the amendments. Third, Congress receives no formal report of sensitive technology contained in a proposed arms sale unless the sale equals or exceeds the $14/$50/$200 million threshold criteria, the rationale being that the administrative burden of reporting a review would exceed the benefits obtained.

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