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STATEMENT OF

Werner Grosshans, Deputy Director

Procurement, Logistics, and Readiness Division

before the

Subcommittee on Oversight

Committee on Ways and Means

House of Representatives

on

OBTAINING NAVY SHIPS

BY LONG-TERM CHARTERS

(RENT-A-NAVY)

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Mr. Chairman and members of the Subcommittee:

I am pleased to have this opportunity to appear before this Subcomittee to discuss the General Accounting Office's (GAO's) prior work on the Navy's program to lease rather than purchase nine tankers. Recent proposals by the Navy and the Air Force to lease rather than purchase Government equipment have prompted several members of Congress to ask us for a detailed review of the issues involved in such leasing arrangements. Although our study has just begun, it will cover economic and budget effects, the magnitude of such leasing arrangements, and their impact on wartime mobilization. Our work should be completed by May 1, 1983.

While the results of our current work are not complete for these hearings, we believe the issues surrounding today's leases are similar to those we reported on earlier.

Our August 15, 1973, report entitled, "Build and Charter Program for Nine Tanker Ships" (B-174839) covered the Navy's build and charter program and its unusual financing method which committed the Government to significant expenditures of funds (fixed charter payments) in future years. By renting instead of purchasing, the Navy applied Operations and Maintenance (O&M) funds over a long period of time, thereby avoiding the type of congressional scrutiny that large procurement outlays would involve.

In June 1972 the Military Sealift Command, Department of the Navy entered into the build and charter program for nine new tankers. Private interests provided for the construction and financing, and the Navy agreed to lease the tankers, with renewal provisions for up to 20 years.

We recognize that leasing is one means of acquiring the use of equipment. However, the magnitude of the funds involved in the nine tanker transaction clearly warranted congressional input to the decisionmaking process. At that time, Navy officials agreed that the manner in which Congress was informed of the program could be improved. To improve congressional visibility of future build and charter programs, we recommended that the Secretary of Defense assist the Congress by

--providing information on the proposed method of acquisition (long-term leasing or purchasing);

--providing appropriate congressional committees a detailed cost analysis showing full impact on future budgets when long-term leasing is the proposed acquisition method; and

--requiring analyses of long-term leasing arrangements to be made on a total-cost-to-the-Government basis, including the direct effects of delayed payments of income taxes.

Ten years ago Navy officials stated that their preference for leasing stemmed from their inability to obtain procurement funds. The requests were denied at higher levels within the Navy or the Department of Defense because procurement funds were needed for higher priority combatant ship construction programs. The build and charter program was designed to meet the Navy's need for new tankers without spending procurement funds.

The nine tankers are operated under the Navy Industrial Fund, a revolving fund reimbursed from appropriated O&M funds from the Army, Navy, Air Force, and Marine Corps. Industrial Fund operations allow the Navy to spread costs to the other military services. The oil and gasoline transportation rates are set annually on the basis of forecasted costs, and the military customers are billed at those rates for services received. Thus, the cost of operating the tanker fleet--including charter costs--are ultimately passed on through the Navy Industrial Fund to the O&M accounts of the military services receiving the transported oil and gasoline products.

The 1972 build and charter program involved 9 ships valued at $160 million. In comparison, the current TAKX maritime prepositioning ship contracts involve 13 ships valued at $2.39 billion. In addition, in 1972, the build and charter program received only the informal review of selected committee staff members. The current program has received written approval of the House and Senate Committees on Armed Services and Appropriations.

While there are some differences between the program in 1972 and the current programs, we do believe that many of the issues raised then are equally important today. These include

--the extent of congressional oversight of long-term leasing arrangements;

--the cost elements to be used in computing the total cost to the Government;

--the discount rate to be used in preparing a present value analysis of the arrangement; and

--the procedures to be used in such comparisons.

Concerning the issue of congressional oversight, we recognize that there is, in the current fiscal year 1983 Defense funding authorization, a notification requirement for these types of ship-leasing transactions. In our previous audit report we recommended that the Congress consider a permanent statutory provision similar to that requiring congressional approval of any proposal to lease a public building at an annual rental in excess of $500,000.

On the issue of the cost elements and the discount rates to be used, we believe the total cost to the Government must be an important consideration. The total costs include not only the lease payment by the agency involved (in this case the Navy), but also the relevant tax revenue consequences to the Treasury of leasing as opposed to purchasing. Such tax consequences are indeed numerous, complex, and occur at different points in time throughout the lease period. Any future costs or revenues must be discounted to current dollars so that the purchase cost can be compared to the total costs of leasing in current dollar terms. The cost comparison of leasing as opposed to purchasing is then sensitive not only to the magnitude of the cost components but also to the interest rate used to discount future costs. Our current work will attempt to deal more with these issues.

Because these leasing arrangements have set a precedent, it may be appropriate for the Department of Defense and the Office of Management and Budget to determine the guidelines that will be used to make these long-term lease-versus-purchase analyses. A clear set of guidelines would also aid Congress in its oversight responsibilities.

This concludes my statement, Mr. Chairman, and I would be happy to respond to any questions you may have.