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STATEMENT OF

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BEFORE THE

COMMITTEE ON BANKING, FINANCE, AND URBAN AFFAIRS

SUBCOMMITTEE ON ECONOMIC STABILIZATION

HOUSE OF REPRESENTATIVES

ON

THE INTERAGENCY STUDY ON MILITARY TRADE OFFSETS

Mr. Chairman, Members of the Subcommittee:

I am pleased to be here today to discuss the results of our recently completed work dealing with the February 1986 interagency report to the Congress titled Impact of Offsets in Defense-Related Exports.[1] Among this report's major findings were the following:

-- The overall magnitude of offset obligations does not appear to be large in the context of either total exports by the companies reporting, or in the context of the value of total military production by these companies.

1See Military Exports: Analysis of an Interagency Study on Trade Offsets (GAO/NSIAD-86-99BR), dated Apr. 4, 1986.

-- The positive effects of sales on employment exceed by far the adverse effects of offsets.

-- Available evidence suggests the profitability of defense-related industries has not been damaged by offsets.

-- Effects of military trade on the total U.S. economy are likely to be close to zero.

At the request of the Chairman, Subcommittee on Oversight and Investigations, House Committee on Energy and Commerce, we examined the scope and methodology of the interagency study on the effect of offsets associated with military exports mandated by the Defense Production Act Amendments of 1984 (P.L. 98-265). We also examined the data base developed for the study, including the design of the questionnaire administered on behalf of the interagency committee by the International Trade Commission (ITC). As such, we did not do an independent assessment of offsets; rather, we examined the approach taken by the administration in doing its work.

Today I will discuss the limitations we found in the interagency study. These included (1) the limited coverage of the study, (2) the design weaknesses in the data collection questionnaire, and (3) the fact that the executive summary--the focal point for presenting the report's findings and conclusions--drew definitive conclusions about offsets without recognizing important qualifications and caveats contained in the body of the report. In addition, I will discuss the considerable internal disagreements which existed among the agencies during the conduct of the study.

STUDY COVERAGE

The interagency study covered sales agreements involving offsets entered into from 1980 to 1984. The data collection questionnaire developed by the interagency committee was sent principally to defense prime contractors and to some subcontractors, but was not sent to nondefense industry sectors also affected by offsets. The interagency report recognized the consequences of these limitations. For example, the report noted that subcontractors were underrepresented to such a point that the survey data collected were likely to underestimate employment effects by a significant amount. According to OMB, which chaired the interagency study effort, the interagency committee considered its mandate to be a macroeconomic assessment of the impact of offsets on the overall U.S. economy--and not to provide an analysis of specific impacts on individual industries or sectors.

In reporting company responses, the interagency report did not clearly distinguish among the total companies sampled (212), the lesser number of companies that reported military sales dollar values (139), and the even smaller grouping which responded to the specific offset questions (63). This could have created the impression of a higher response rate to specific questions or greater validity to points being made than may be warranted.

One last point on the scope of the study--it did not attempt to assess the long-term impact of offsets. Given the transfer of technology and manufacturing know-how associated with many offset arrangements, the long-term effect is an important dimension of any offset discussion.

QUESTIONNAIRE DESIGN LIMITED DATA COLLECTED

Portions of the questionnaire used to collect offset data were not well designed. The questionnaire included nonstandardized (open-ended) response formats and undefined terms. For example, one question asked respondents to describe the domestic employment impact on their firms of the sales agreement and offset-related obligations under consideration. The term "domestic employment impact" was not defined, and the question did not specify the time period to be considered, the type of response desired--i.e., quantitative and/or qualitative--or whether both positive and negative impacts were to be reported. Given that a narrative response was solicited, the response format for this question could have discouraged companies from giving a detailed response since only two blank lines were provided for an answer. These design problems could have led to imprecise tabulations, nonresponses, and/or a lack of uniform responses; our examination of selected responses showed that nonuniform responses were in fact obtained. This generally makes it difficult to aggregate data and draw definitive conclusions.

There were other design problems. For example, several questions solicited multiple answers, but the format did not provide for separate responses. Other questions seemed to limit the information sought. As an example, one question asked for the name of competing firms for individual sales contracts; it did not ask whether those firms were thought to be offering offsets, or whether offsets were being offered by both U.S. and foreign competitors.

In addition to questionnaire design limitations, our review of a small sample of completed questionnaires showed some errors in ITC's processing of questionnaire responses, resulting in both overreporting of sales by $700 million and underreporting of offset values by $96 million. We further noted--based on matching some subcontractor narrative responses to data on offsets reported by prime contractors--that offsets totalling over $300 million were reported by subcontractors but may not have been reported as part of the total offset values by their prime contractors. We were unable to verify the accuracy or completeness of reporting by respondents other than to test for discrepancies evidenced by conflicting data.

We also found over $110 million in offsets which were not included in the total value of offsets reported because they were reported by U.S. companies serving as subcontractors to foreign prime contractors; the latter were not included in the survey.

STUDY FINDINGS NOT APPROPRIATELY QUALIFIED

The report's executive summary provided the focal point for its findings and conclusions. While the report recognized that certain industrial sectors not included in the study might be affected by offsets and that long-term effects were not measured, its findings were not qualified to reflect this. Because the executive summary did not mention the caveats and qualifications contained in the body of the report concerning data and analysis limitations, some findings read like firmly substantiated conclusions. Our report cited several examples; I will highlight just one here.

The report's executive summary states that "the employment effects of the sales exceed by far the adverse effects of offsets." It goes on to say that "even when one considers the upper-bound estimates, the study finds that the positive effects of sales exceed the adverse effects by about 62,000 job opportunities." However, the body of the report points out that both survey data and an economic technique used in developing the employment estimate have important limitations. The executive summary finding was not qualified to indicate that adequate information was not obtained from some important industry sectors which might be adversely affected by offsets. Nor did the finding specify that the examination of long-term effects was beyond the study's scope. In the absence of better data or methodologies, we believe the finding should not have been worded in such definitive terms.

TWO AGENCIES DISAGREED WITH THE ISSUED REPORT

A number of agencies worked with OMB in producing the interagency report. Principal agencies were the Departments of Commerce, Defense, Labor, and Treasury. However, due to disagreement over the study approach, Treasury withdrew from participation in writing the report.

In December 1985, Treasury and Commerce sent letters to OMB, expressing disagreement with the report the interagency committee planned to submit to the Congress. Treasury objected to the report, noting that it added no new information on offsets and that it contained numerous unsubstantiated assertions, erroneous conclusions, and contradictory statements. OMB officials told us that the report was not changed from December 1985 until it was issued in February 1986.

Commerce also did not concur with the report, stating that the segment on industrial competitiveness no longer contained the substance or perspective of the draft that Commerce had submitted. Commerce objected because of major changes and deletions which were made in its draft chapter. An OMB official told us that revisions were made to the Commerce draft because it contained numerous unsubstantiated assertions; and that a consensus for the deletions existed among the coordinating committee members. Commerce officials maintained that support for the deleted information was referenced in various footnotes which were also deleted from their draft. Several officials at both Commerce and Treasury also disagreed with the report on the grounds that it did not objectively present the available data.

ACCESS TO DATA COLLECTED WAS A PROBLEM

The ITC, although not a member of the interagency coordinating committee, played a major role in collecting and processing the questionnaire data. ITC added the interagency's questions to a questionnaire it was finalizing for its own study of barter and countertrade. A controversy developed over what information was to be made available for the interagency study from the completed data collection effort even as the questionnaire was being finalized and sent out. Coordinating committee members assumed that they would have access to all information collected by ITC in order to do their analysis of the offset issue. As is its practice, ITC promised respondents confidentiality in a statement added to the questionnaire. ITC declined to provide specific data it considered business sensitive--names of companies and competitors for a sale, product descriptions, and other identifying data--and indicated it would provide information only in the aggregate. Commerce, Labor, and Treasury's position was that this approach would constrain their analyses of offsets. Their comments reflected the desire to begin with a microanalysis of individual sectors and firms versus OMB's macroeconomic approach.

This concludes my prepared remarks. I will be happy to answer any questions you might have.